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In the
Supreme Court of the United States

OCTOBER TERM, 1991

GEORGE O. SANDERS, GEORGE H. O'BRIEN and
TANBARK OIL COMPANY 1987-1, LTD.,
Petitioners,

v.

CITY OF BRADY, TEXAS, Successor
in interest to Brady, Texas Municipal
Gas Corporation,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Does federal law control whether a federal court may conduct further proceedings in a case in which its non-dispositive interlocutory order has been given preclusive effect in subsequent state court proceedings?
2. Does a state court judgment giving preclusive effect to a nondispositive interlocutory order of a federal court bar further proceedings in the federal court case in which the order was entered?

PARTIES TO THE PROCEEDINGS BELOW

All parties to the proceedings below appear in the style of this case. Further, there are no parent or subsidiary companies to be listed pursuant to S.Ct. R. P. 29.1.

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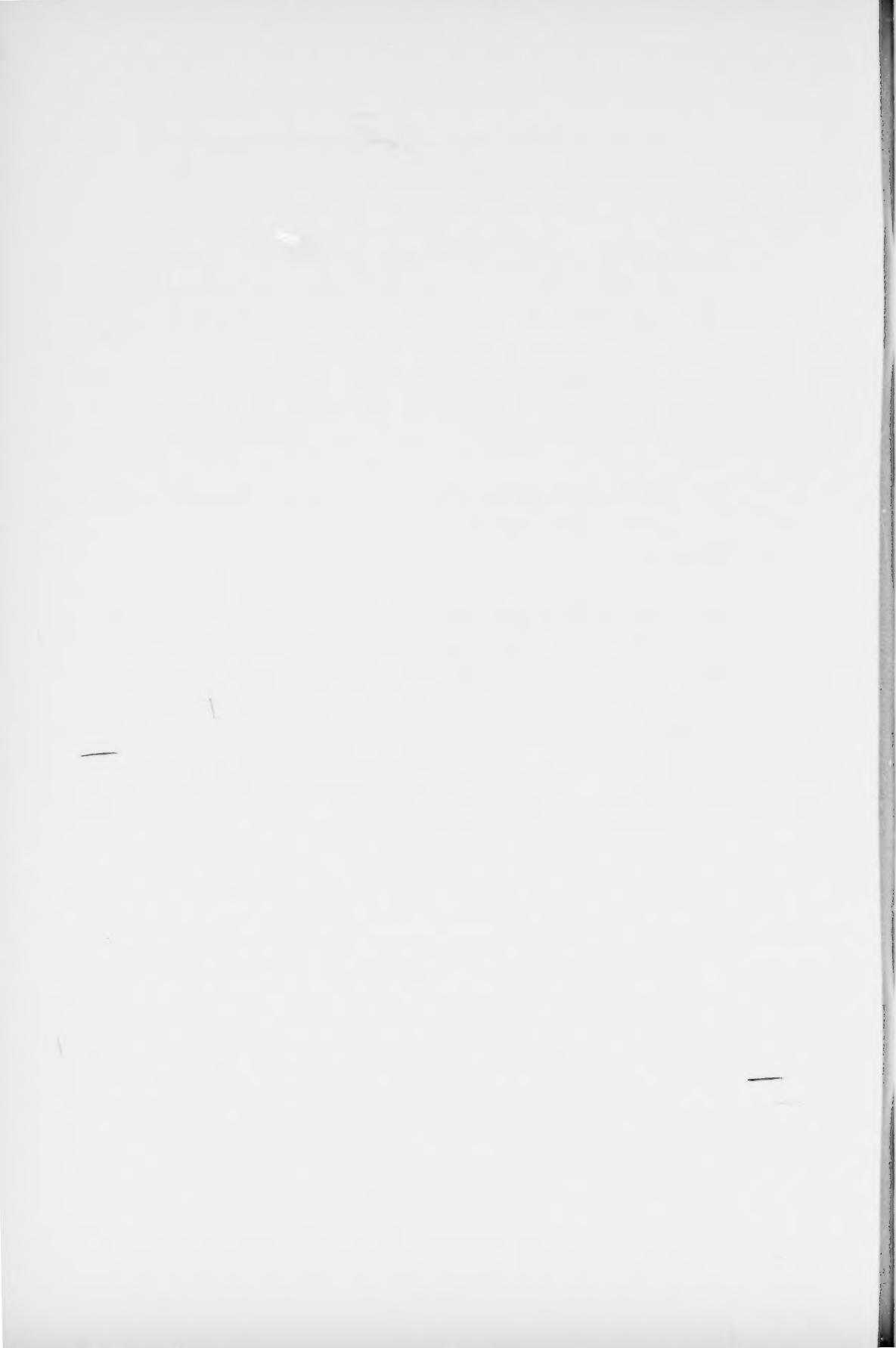
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GEORGE O. SANDERS, GEORGE H. O'BRIEN and
TANBARK OIL COMPANY 1987-1, LTD.,
Petitioners,

V.

CITY OF BRADY, TEXAS, Successor
in interest to Brady, Texas Municipal
Gas Corporation,
Respondent.

PETITION FOR WRIT OF CERTIORARI

George Sanders, George H. O'Brien and Tanbark Oil Company 1978-1, Ltd. (referred to collectively as "Sanders") petition for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit (the "Court of Appeals") affirming the judgment of the United States District Court for the Western District of Texas, Austin Division (the "District Court") and holding as barred by *res judicata* further proceedings in the United States Bankruptcy Court for the Western District of Texas, Austin Division (the "Bankruptcy Court").

OPINIONS BELOW

The opinion of the Court of Appeals affirming the District Court's judgment (APPENDIX, pp. A-19) is

reported at *Matter of Brady, Texas Municipal Gas Corp.*, 936 F.2d 212 (5th Cir. 1991). The judgment of the District Court affirming the Bankruptcy Court, *Sanders v. Brady, Texas Municipal Gas Corp.*, Case No. 89-CA-429, *slip op.* (W.D. Tex. March 27, 1991) (APPENDIX, pp. A-19 - A-22) is not reported. The opinions of the Bankruptcy Court initially rejecting application of *res judicata* to this case, *In re Brady, Texas Municipal Gas Corp.*, Case No. 1-80-BK-00219, *slip op.* (Bankr. W.D. Tex. Aug. 6, 1986) (APPENDIX, pp. A-52 - A-60) but subsequently reversing itself and holding proceedings as barred by *res judicata*, *In re Brady, Texas Municipal Gas Corp.*, Case No. 1-80-BK-00219, *slip op.* (Bankr. W.D. Tex. March 24, 1989) (APPENDIX, pp. A-23 - A-51) are likewise not reported.

JURISDICTION OF THE COURT

The judgment and opinion of the Court of Appeals of which review is sought herein was entered on July 24, 1991. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

STATUTE INVOLVED

The federal statute involved in these proceedings is the Full Faith and Credit Act, 28 U.S.C. §1738, which provides as follows:

The Acts of the legislature of any State, Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in

other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

STATEMENT OF THE CASE

In 1978 Brady, Texas Municipal Gas Corporation (Brady Gas) signed a farm-out agreement with George H. O'Brien, under which Brady Gas agreed to assign its mineral leases to O'Brien for any acreage on which a well was completed. O'Brien assigned a portion of his interest in the farm-out agreement to Vista Resources, Inc., which in turn assigned all its interest to Tanbark Oil Company. George O. Sanders is the successor-in-interest to Vista and Tanbark.

In 1979 Sanders sued Brady Gas in the District Court of Brown County, State of Texas (the "State Court") for breach of the farm-out agreement, seeking equitable title to Brady Gas' leases or damages for the cost of completing the wells. Before disposition by the State Court, Brady Gas filed for bankruptcy protection as a debtor in possession in Case No. 1-80-BK-00219 (the "Bankruptcy Case") in the Bankruptcy Court.

On October 20, 1980 Brady Gas filed a proposed plan of reorganization that rejected the farm-out agreement as

an executory contract. Sanders thereupon commenced Adversary No. 1-80-0096 (the "Adversary Proceeding") in the Bankruptcy Court seeking to recover the leases from Brady Gas, and filed a proof of claim in the Bankruptcy Case seeking \$1,650,000 in damages. Brady Gas counterclaimed in the Adversary Proceeding for reformation or cancellation of the farm-out agreement.

On January 12, 1981 Brady Gas filed its First Alternate Plan of Reorganization (the "Alternate Plan"). The Alternate Plan provided that the City would pay the bond debts and current liabilities of Brady Gas, assume its contracts and obligations and accept a transfer of Brady Gas' assets. Like the initial plan, the Alternate Plan provided for rejection of the farm-out agreement and payment of Sanders' proof of claim in an amount to be determined in subsequent proceedings. The Bankruptcy Court ultimately approved the Alternate Plan over Sanders' objection.

In October 1983 Sanders added the City as a defendant to the State Court action. The City moved for summary judgment, asserting erroneously that confirmation of the Alternate Plan barred the State Court action as *res judicata*. The State Court agreed. *See Vista Resources, Inc. v. Brady, Texas Municipal Gas Corp.*, Case No. 21, 138, *slip op.* (Dist. Ct. of Brown County, 35th Jud. Dist. of Texas, Dec. 18, 1984) (APPENDIX, pp. A-67 - A-69). Sanders appealed to the Texas Eleventh Circuit Court of Appeals (the "State Appellate Court"), which affirmed the State Court's summary judgment. *See Tanbark Oil Co. 1978-1, Ltd. v. City of Brady*, Case No. 11-85-080-CV, *slip op.* (Tex. App. - Eastland, Aug. 22, 1985, *writ ref'd n.r.e.*). (APPENDIX, pp. A-63 - A-66). Sanders' application for writ of error to the Texas Supreme Court was subsequently refused. *See Tanbark Oil Co. 1978-1, Ltd. v. City of Brady*, No. C-4779, 29 Tex. Sup. Ct.J. 140-41 (Jan. 18, 1986).

While the application for writ of error was pending, Sanders moved in the Bankruptcy Case to compel the City to pay his \$1,650,000.00 proof of claim, to which Brady Gas had never objected. The City responded that the State Court judgment was *res judicata* as to Sanders' claim in the Bankruptcy Case and that Brady Gas had objected to the proof of claim with its counterclaim in the Adversary Proceeding.

On August 6, 1986 the Bankruptcy Court, Judge R. Glen Ayers presiding, issued a memorandum opinion ("Judge Ayers' Opinion") which rejected preclusion by the State Court judgment. *See In re Brady, Texas Municipal Gas Corp.*, Case No. 1-80-BK-00219, *slip op.* (Bankr. W.D. Tex. Aug. 6, 1986) (APPENDIX, pp. A-52 - A-60). Judge Ayers concluded that it would be irrational and inequitable to refuse to address the merits of the proof of claim simply because the State Court erroneously assumed that the Bankruptcy Court had already done so, all at the invitation of the City.

The case was subsequently transferred to Judge Larry E. Kelly, who ordered further briefing on tangentially related issues. On March 24, 1989, Judge Kelly issued a memorandum opinion ("Judge Kelly's Opinion") that overruled Judge Ayers' Opinion, afforded full faith and credit in the Bankruptcy Case to the State Court judgment and held the proof of claim barred as *res judicata*. *In re Brady, Texas Municipal Gas Corp.*, Case No. 1-80-BK-00219, *slip op.* (Bankr. W.D. Tex. March 24, 1989) (APPENDIX, pp. A-23 - A-51). The Bankruptcy Court thus denied Sanders' motion to compel distribution of funds.

Sanders appealed Judge Kelly's Opinion to the District Court pursuant to 28 U.S.C. §158. The City cross-appealed, raising issues relevant to a reinstatement

of the Adversary Proceeding, dismissal of Brady Gas' counterclaim therein and disposition of the City's claim that Brady Gas had effectively objected to Sanders' proof of claim. The District Court affirmed summarily. *See Sanders v. Brady, Texas Municipal Gas Corp.*, Case No. 89-CA-429, *slip op.* (W.D. Tex. March 27, 1990) (APPENDIX, pp. A-19 - A-22). Both Sanders and the City sought further review in the Court of Appeals, which affirmed the District Court as to disposition of the proof of claim as *res judicata* and ignored as moot the City's cross-appeal. *See Matter of Brady, Texas Municipal Gas Corp.*, 936 F.2d 212 (5th Cir. 1991) (APPENDIX, pp. A-1 - A-18). Sanders now seeks review by this Court by petition for writ of certiorari.

REASONS FOR ALLOWING THE WRIT

The decisions by the Bankruptcy Court, the District Court and the Court of Appeals all stand for the proposition that a federal court must look to state law to determine whether it may conduct further proceedings after its nondispositive interlocutory order simply because a state court erroneously finds that order to be *res judicata*. This Court has never addressed such a proposition, its closest case being *Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518, 106 S.Ct. 768, 88 L.Ed.2d 877 (1986), which answered in the affirmative the question whether the Full Faith and Credit Act mandates that state law control federal court acceptance of a state court decision *rejecting* preclusive effect of a federal judgment. This case therefore raises two questions never addressed by this Court: (1) whether a federal court need look to state law under the Full Faith and Credit Act to determine the appropriateness of further proceedings after its nondispositive interlocutory order has been found to be *res judicata* by a state court; and, (2) whether the Full Faith and Credit Act requires federal court acceptance of a state court decision

imposing preclusive effect upon a federal order.

Neither has the Court had occasion to address the problem of circular preclusion, which resulted in this case because the proceedings barred were the very ones in which the nondispositive interlocutory order held to be *res judicata* arose. On this point there is apparently a conflict between the federal circuits, the Court of Appeals in this case countenancing such circularity while the District of Columbia Circuit does not. *See McLaughlin v. Alban*, 775 F.2d 389, 391 (D.C. Cir. 1985).

This case thus involves important questions of federal law that have not been, but should be, settled by this Court. *See S.Ct. R. P. 10.1.(c)*. It likewise involves a conflict between courts of appeals on the same issue. *See S.Ct. R. P. 10.1.(a)*. For these reasons, Sanders submits that the case is appropriate for review by this Court on writ of certiorari and urges that the writ be granted.

A. Federal Law Determines Whether Further Proceedings May Follow a Nondispositive Interlocutory Order In Federal Court

Initially, it should be noted that the Bankruptcy Court was not required to look to the Full Faith and Credit Act, *Parsons Steel* or Texas law to determine whether further proceedings could be had upon Sanders' motion to compel distribution. The Bankruptcy Court need only have looked to its order confirming the Alternate Plan, since the motion was simply a continuation of proceedings ongoing in the Bankruptcy Case. Because the order was indisputably interlocutory and nondispositive under federal law, a proposition none of the federal courts herein have denied, no further inquiry was required. In this regard, the question is not one of full faith and credit but instead

whether the Bankruptcy Court rather than the State Court should determine the appropriateness of further proceedings in the ongoing Bankruptcy Case.

It is clear that the Alternate Plan contemplated further proceedings regarding Sanders' claim in connection with the farm-out agreement. To this extent, the City's resort to the State Court judgment to prohibit such proceedings can thus be seen as an effort to obtain relief from the Bankruptcy Court's order confirming the Alternate Plan. Of course, such relief could only have been obtained from courts having jurisdiction of the Bankruptcy Court's order, *i.e.*, the federal courts. *See Delaware Valley Citizens Council v. Pennsylvania*, 755 F.2d 38, 42 (3rd Cir. 1985), *cert. denied*, 474 U.S. 819, 106 S.Ct. 67, 88 L.Ed.2d 54 (1986) ("relief from a decision of this court in a federal case can only be obtained from the United States Supreme Court and not from the Supreme Court of Pennsylvania"). And any state court addressing the effect of such an order would clearly be bound by federal law in determining the preclusive effect of the order. As stated in *Stoll v. Gottlieb*, 305 U.S. 165, 59 S.Ct. 134, 83 L.Ed. 104 (1928):

[The Full Faith and Credit Act] is broader than the authority granted by Article Four, section one, of the Constitution to prescribe the manner of proof and the effect of the judicial proceedings of states. Under it the judgments and decrees of the federal courts in a state are declared to have the same dignity in the courts of that state as those of its own courts in a like case and under similar circumstances.

305 U.S. at 170, 83 L.Ed. at 107-08. The *Delaware Valley* court further held expounded on *Stoll*:

[A]lthough Congress implemented the Constitu-

tion's full faith and credit clause of Article IV, §1, in language referring only to state courts, there is a clearly established rule that state courts must give full faith and credit to the proceedings of federal courts. That this is the rule is beyond doubt, and the state courts have generally accepted it.

755 F.2d at 44, *citing* Degan, *Federalized Res Judicata*, 85 Yale L.J. 741, 744 (1976). *See generally* 18 C. Wright, A. Miller & E. Cooper, *Federal Practice & Procedure: Civil* §4468.

The foregoing analysis demonstrates that federal law controls the preclusive effect of a federal order. This is as true with respect to interlocutory decisions as it is to final judgments; state courts simply have no power to interfere with pending federal cases. 755 F.2d at 46 (concurring opinion), *citing* 18 C. Wright, A. Miller & E. Cooper, *Federal Practice & Procedure: Civil* §4468. The Court of Appeals below has itself recognized this basic rule:

The principle of finality essential to a court's authority demands that federal law determine the effects under the rules of res judicata of a judgment of a federal court.

Hardy v. Johns-Manville Sales Corp., 681 F.2d 334, 337 (5th Cir. 1982), *citing* Restatement (2d) of Judgments §87 (1982).

It is clear that the Bankruptcy Court did not look to federal law to determine whether it could conduct further proceedings on Sanders' motion to compel distribution. Had it done so, it would have concluded that the order confirming the Alternate Plan was neither final nor dispositive and entertained Sanders' claim on its merits, as it initially

reasoned it must do in Judge Ayers' Opinion:

[I]t is difficult to conceive of a preclusion rule that would prevent consideration [of Sanders' claim] by this Court. The state courts both presumed that this Court had issued a ruling in the claim. That had never occurred. While a state court judgment *misinterpreting* an order of a federal court might not be subject to reconsideration under the doctrine of preclusion, how can a state court order on a ruling concerning a *non-existent* ruling or order of *this* Court be said to be preclusive? [emphasis added]

In re Brady, Texas Municipal Gas Corp., Case No. 1-80-BK-00219, *slip op.* at 9 (Bankr. W.D. Texas Aug. 6, 1986) (APPENDIX, pp. A-59 - A-60). Instead it looked to state law and the State Court judgment to address the question, and as a result reached the erroneous conclusion that no further proceedings could be had. *See In re Brady, Texas Municipal Gas Corp.*, Case No. 1-80-BK-00219, *slip op.* at 23 (Bankr. W.D. Tex. March 24, 1989) (APPENDIX, pp. A-50 - A-51).

B. Federal Law Determines the Preclusive Effect of the State Court Judgment in This Case

As discussed above, federal law governs the preclusive effect of the nondispositive interlocutory order confirming the Alternative Plan. Likewise, assuming *arguendo* that a full faith and credit analysis was required, on the peculiar facts of this case federal law governs the preclusive effect to be afforded the State Court judgment in the Bankruptcy Case. This is so because *Parsons Steel* and the line of cases it typifies have left open the question present in this case and because the Full Faith and Credit Act is not offended by a refusal to afford *res judicata*

effect to the State Court judgment in this case.

1. *Parsons Steel* is inapposite

In *Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518, 106 S.Ct. 768, 88 L.Ed.2d 877 (1986), the plaintiffs sued the defendant bank in both state and federal court simultaneously, alleging that the bank's conduct was violative of both state and federal law. The federal case proceeded to trial first and a jury verdict was returned in favor of the plaintiffs, but the district court granted judgment notwithstanding the verdict to the bank. *See Parsons Steel, Inc. v. First Alabama Bank of Montgomery*, 679 F.2d 242 (11th Cir. 1982). The bank pleaded the federal judgment to bar the state case as *res judicata*. The state court rejected the plea and returned a verdict in favor of the plaintiffs. The bank returned to the federal district court, which enjoined the state court action on the rationale that the state claims could have been raised in the federal case and were therefore barred as *res judicata* by the federal judgment. The federal court of appeals affirmed, holding the injunction proper under the "relitigation exception" of the federal Anti-Injunction Act, 28 U.S.C. §2283. *First Alabama Bank v. Parsons Steel*, 747 F.2d 1367 (11th Cir. 1984).

On further review this Court found that the lower courts "gave unwarrantedly short shrift to the important values of federalism and comity embodied in the Full Faith and Credit Act." *Parsons Steel*, 474 U.S. at 523, 88 L.Ed.2d at 883. Reaffirming its decisions in *Marrese v. American Academy of Orthopedic Surgeons*, 470 U.S. 373, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985) and *Migra v. Warren City School Dist. Bd. of Education*, 465 U.S. 75, 104 S.Ct. 892, 79 L.Ed.2d 56 (1984), the Court held that the Full Faith and Credit Act required a federal court to give the same

preclusive effect to a state court judgment that another court of that state would give, reasoning as follows:

It has long established that §1738 does not allow federal courts to employ their own rules of *res judicata* in determining the effect of state judgments. Rather, it goes beyond the common law and commands a federal court to accept the rules chosen by the State from which the judgment is taken.

474 U.S. at 523; 88 L.Ed.2d at 883, quoting *Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 481-482, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982). The Court further held that “[t]he Full Faith and Credit Act thus allow[s] the States to determine, subject to the requirements of the statute and the Due Process Clause, the preclusive effect of judgments in their own courts,” and concluded that “the Anti-Injunction Act and the Full Faith and Credit Act can be construed consistently, simply by limiting the relitigation exception of the Anti-Injunction Act to those situations in which the state court has not yet ruled on the merits of the *res judicata* issue.” 474 U.S. at 523-24, 88 L.Ed.2d at 883-884. The Court added that “once the state court has finally *rejected* a claim of *res judicata*, then the Full Faith and Credit Act becomes applicable and federal courts must turn to state law to determine the preclusive effect of the state court’s decision.” 474 U.S. at 524; 88 L.Ed.2d at 884 [emphasis added].

As the foregoing discussion demonstrates, the Court has spoken to enforcement in federal court of a state court’s decision that a federal court order has no *res judicata* effect on further proceedings in state court. It has not spoken to, and indeed did not address in *Parsons Steel*, the enforcement in federal court of a state court’s decision that a prior interlocutory order in federal court was *res*

judica as to the claim raised therein. See 18 C. Wright, A. Miller & E. Cooper, *Federal Practice & Procedure*: Civil §4470 ("The Supreme Court has made it clear that claim preclusion must be denied if state courts would deny it, but left the way open to deny claim preclusion as a matter of federal law if state courts would grant it"). Clearly, *Parsons Steel* and its antecedents do not mandate that the State Court's decision as to *res judicata* must be followed by the Bankruptcy Court or that Bankruptcy Court need have resorted to state law at all. The Court of Appeals' contrary holding, *see* 936 F.2d at 217, was an unwarranted extension of *Parsons Steel*.

Because *Parsons Steel* and its antecedents are inapplicable, the question whether a federal court must honor a state court decision *giving* preclusive effect its own non-dispositive interlocutory order may be determined by federal law. Sanders submits that such federal law would deny application of *res judicata* in this case. This is so for two reasons. First, as was discussed above, it is undisputed that as a matter of federal law the Bankruptcy Court's order confirming the Alternate Plan was neither final nor dispositive. Further, as will be discussed below, the Full Faith and Credit Act is not offended by permitting the Bankruptcy Court to conduct further proceedings in the Bankruptcy Case.

2. The Full Faith and Credit Act is not offended by further proceedings in this case

As discussed above, *Parsons Steel* is inapplicable to this case. Whether the Full Faith and Credit Act would nevertheless require that the State Court judgment be afforded preclusive effect as a matter of federal law must first focus on whether the Act itself is offended by further

proceedings in the Bankruptcy Case.

- a. The purposes of the Full Faith and Credit Act are not served by affording *res judicata* effect to the State Court Judgment

Sanders submits that the purpose of the Full Faith and Credit Act is served so long as the State Court judgment is afforded preclusive effect in any proceeding other than the Bankruptcy Case. This is highlighted by the Court of Appeals' analysis of *Eichman v. Fotomat Corp.*, 880 F.2d 149 (9th Cir. 1989), which is cited for the proposition that "[a] state court's determination that a second action was barred by claim preclusion will bar a third identical action in the federal court." 936 F.2d at 219. Sanders does not disagree with this general proposition but would note that it is, like *Parsons Steel*, inapplicable to the facts of this case. In *Eichman*, the first action was disposed of in state court, a second such action was found to be barred as *res judicata* and a third action, commenced in federal court, was likewise barred. 880 F.2d at 155. Of course, there was no "third action" in this case; there was rather an attempt to foreclose proceedings in the first action, the Bankruptcy Case, by the outcome of the second in the State Court.

Were proceedings on Sanders' motion to compel distribution an entirely new action rather than further proceedings in the ongoing Bankruptcy Case, Sanders would agree that the Full Faith and Credit Act would require the State Court judgment be afforded preclusive effect. However, the State Court judgment should not be afforded such effect to preclude further proceedings in the very case from which the bar is alleged to have arisen; to do so is to allow the State Court, rather than the Bankruptcy Court, to determine whether the order confirming the Alternate

Plan disposed of Sanders' claim and whether further proceedings were appropriate. The purpose of the Full Faith and Credit Act is simply not served by such a result because the State Court has no interest in seeing its judgment control whether the Bankruptcy Court could conduct further proceedings in its own ongoing case.

- b. The Full Faith and Credit Act is not offended by the avoidance of circular preclusion

A case more factually and procedurally apposite to this case than *Eichman* is *McLaughlin v. Alban*, 775 F.2d 389 (D.C. Cir. 1985). In *McLaughlin*, cases were commenced in state court, the District of Columbia federal court, and a Maryland federal court. A second action was later filed in the District of Columbia federal court. The defendants obtained judgment in the state court case and in the first District of Columbia federal case. The federal judgment was then found to preclude the action in second District of Columbia case. *Id.* at 390. Entertaining the appeal of the first federal judgment, the federal circuit court held that the second federal judgment was not entitled to preclusive effect as to the first federal judgment because it was based thereon. *Id.* at 391.

The problem addressed in *McLaughlin* has been identified as "circular preclusion." See generally 18 C. Wright, A. Miller & E. Cooper, *Federal Practice & Procedure: Civil* §4404. The commentators note:

Modern approaches to finality may lead a second court to apply preclusion on the basis of determinations made in proceedings that have not led to a final judgment in the first court [citing §4433

and 4434] ... [i]t is clear that the preclusion-based judgment in the second court [here the state courts] should not then become a basis for preclusion in the first court.

Id. at §4404 n.1, *citing McLaughlin*, 775 F.2d at 391. The circularity problem is evident in this case, as the Bankruptcy Court intuitively noted in Judge Ayers' Opinion:

It is difficult to conceive of a preclusion rule that would prevent consideration [of Sanders' claim] by this Court. The state courts both presumed that this Court had issued a ruling in the claim. That had never occurred. While a state court judgment *misinterpreting* an order of a federal court might not be subject to reconsideration under the doctrine of preclusion, how can a state court order on a ruling concerning a *non-existent* ruling or order of *this* Court be said to be preclusive? [emphasis added].

In re Brady, Texas Municipal Gas Corp., Case No. 1-80-BK-00219, *slip op.* at 9 (Bankr. W.D. Tex. Aug. 6, 1986) (APPENDIX, pp. A-59 - A-60).

Although it may not have recognized the trap into which it was being drawn by the City, the Bankruptcy Court clearly recognized that it was to be avoided. The order confirming the Alternate Plan gave rise to the State Court judgment, which was then applied to the proceedings from which the order arose. This is exactly the result that was rejected in *McLaughlin*.

The Court of Appeals demonstrated a fundamental misunderstanding of the circularity problem, regarding it as a question of state law. For this reason it found circular preclusion irrelevant, noting that it was "not demonstrated

that the Texas courts would give less deference to an erroneous determination of finality than to an erroneous determination of other issues that might have been decided in a prior proceeding." 936 F.2d at 220 (APPENDIX, pp. A-16). Of course, Sanders has never argued that the avoidance of circular preclusion in this case was a question of state law; he has instead contended that federal law should disfavor a court allowing its own nondispositive interlocutory order to circularly preclude further proceedings on that order. And of course this case is not about finality, except to the extent that a nondispositive order should not bar further proceedings in the same case simply because another court erroneously believes that it does.

Sanders submits that the Full Faith and Credit Act is not offended by enforcement of a federal policy to avoid circular preclusion. The State Court had no interest in seeing its judgment so employed, and the Bankruptcy Court should not have interpreted the Full Faith and Credit Act to require such a result.

CONCLUSION

The Bankruptcy Court erroneously allowed a State Court judgment based on its own nondispositive interlocutory order to preclude further proceedings in the very case in which that order was entered. The Court of Appeals affirmed this action. In so doing, it decided questions not previously addressed by this Court in *Parsons Steel* and its antecedents, *see S.Ct. R. P. 10.1.(c)*, and created a conflict among the federal circuits as to circular preclusion. *See S.Ct. R. P. 10.1(a)*. For these reasons, Sanders urges that the Court issue a writ of certiorari to the Court of Appeals to review its judgment and opinion.

DATED this the 21st day of October, 1991.

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APPENDIX A

**In the Matter of BRADY, TEXAS
MUNICIPAL GAS CORPORATION,
Debtor.**

**George O. SANDERS, George H. O'Brien,
and Tanbark Oil Company 1978-1, Ltd.
Appellants-Cross-Appellees,**

v.

**CITY OF BRADY, Successor-in-Interest,
Appellee-Cross-Appellant.**

**In the Matter of BRADY, TEXAS
MUNICIPAL GAS CORPORATION.**

**The CITY OF BRADY, TEXAS,
Appellee-Cross-Appellant,**

v.

**George O. SANDERS, et al.,
Appellant-Cross-Appellee.**

No. 90-8282.

**United States Court of Appeals,
Fifth Circuit**

July 24, 1991.

Creditors, whose executory agreement with Chapter 11 debtor had been rejected, brought claim for damages. The United States Bankruptcy Court for the Western District of Texas, Larry E. Kelly, Chief Judge, denied

claim, and appeal was taken. The District Court, James R. Nowlin, J., affirmed, and further appeal was taken. The Court of Appeals, Thornberry, Circuit Judge, held that state court's determination that creditors of debtor's successor in interest were barred from pursuing claim by their failure to pursue it in bankruptcy court constituted judgment on merits to which bankruptcy court was required to give full faith and credit, even if state court's determination was erroneous.

Affirmed.

Before THORNBERRY, JOLLY, and SMITH, Circuit Judges.

THORNBERRY, Circuit Judge:

The bankruptcy court confirmed a municipal gas corporation's plan of reorganization that rejected a farm-out agreement with the appellants but gave them the right to pursue a damage claim against the debtor for breaching the agreement. Rather than remaining in the federal court, the appellants proceeded against the debtor and its successor-in-interest in a Texas state court, which ruled that the bankruptcy court's confirmation of the debtor's reorganization plan collaterally estopped the appellants from pursuing their damage claim against the debtor and its successor-in-interest. The appellants returned to the bankruptcy court, but that court dismissed their claim, holding that the state court's erroneous interpretation of the effect of the reorganization plan was binding on the federal bankruptcy court under the Full Faith and Credit Act, 28 U.S.C. § 1738. The district court summarily affirmed the bankruptcy court's order.

We agree with the reasoning of the bankruptcy

court, and, therefore, we AFFIRM the order dismissing the appellants' claim against the debtor and its successor-in-interest. Our resolution of this dispute obviates a discussion of the issues raised in the cross-appeal.

FACTS AND PROCEDURAL HISTORY

Brady, Texas, Municipal Gas Corporation (Brady Gas) owned mineral and gas leases in Brown County, Texas. In April 1978, Brady Gas signed a farm-out agreement with George H. O'Brien, which provided that Brady Gas would assign its leases, or a portion of them, to O'Brien for any acreage on which O'Brien completed one or more wells. In July 1978, O'Brien assigned a portion of his interest in the farm-out agreement to Vista Resources, Inc. One month later, Vista assigned all its interest to Tanbark Oil Company. George O. Sanders is the successor-in-interest to Vista and Tanbark. For convenience, these entities and individuals will be referred to, collectively as the "appellants."

In September 1979, the appellants sued Brady Gas in the Texas State District Court in Brown County, Texas, alleging that they had completed three wells on acreage covered by the agreement but that Brady Gas had refused to assign to them the leases to those areas. The appellants asked the court either to award them equitable title to those leases or to award them damages for the cost of completing the wells. In June 1980, before the state court had made any ruling in the case, Brady Gas filed for bankruptcy under Chapter 11. The City of Brady, which owned the entire equity interest of Brady Gas, filed a proof of interest.

On October 20, 1980, Brady Gas filed a proposed plan for reorganization that rejected the farm-out agreement as an executory contract. *See* Bankr. Code §365(a). On

that same day, the appellants initiated an adversary proceeding against Brady Gas asking the bankruptcy court to order Brady Gas to assign the leases to them. The next month, Brady Gas filed an answer to the adversary proceeding and also filed a counterclaim, which asserted that the farmout agreement was ambiguous, and which asked the bankruptcy court either to reform it or to declare it null and void.

[1] Under the Bankruptcy Code, the rejection of an executory contract constitutes a breach of the contract, and an aggrieved party can assert a claim for damages. *See id.* §§ 365(g)(1), 502(g). Accordingly, in December 1980, the appellants filed a proof of claim in the bankruptcy court asking for \$1,650,000 in damages. Therefore, in the bankruptcy court, the appellants had filed the adversary proceeding seeking specific performance and a proof of claim seeking damages. Meanwhile, the state court action was still pending.

On January 12, 1981, Brady Gas filed its First Alternate Plan of Reorganization. *See Record on Appeal ("R.")*, vol. 8, tab 6. This plan proposed that the City of Brady would pay the bond debts and current liabilities of Brady Gas and would assume its contracts and obligations. In exchange, Brady Gas would transfer its assets to the City. Like the initial plan, the Alternate Plan proposed to reject the farm-out agreement as an executory contract. The Alternate Plan proposed to pay the appellants' claim "in an amount equal to and at such time as a court of competent jurisdiction determine[d] that such claims are due and in what amount." But Article IX of the plan also stated that the bankruptcy court "[would] retain jurisdiction" over the "determination of all causes of action, controversies, disputes, or conflicts, whether or not subject to pending action as of the date of confirmation."

In February, the bankruptcy court approved the Alternate Plan over the appellants' objection. Two days after the plan was confirmed, the appellants filed a notice of appeal, but the district court dismissed the appeal in October 1982 for failure to prosecute. From February 1981 until October 1983, the appellants took no further action in either the bankruptcy court or in the state court.

In October 1983, the appellants returned to the state court and filed an amended petition adding the City of Brady as a defendant. Approximately one year later, the City moved for summary judgment, asserting that the confirmation of the reorganization plan barred the appellants' state court action under the doctrine of res judicata. In December 1984, the state trial court entered summary judgment against the appellants. *See Vista Resources, Inc. v. Brady, Texas, Mun. Gas Corp.*, No. 21-138 (Dist.Ct. of Brown County, 35th Judicial Dist. of Texas, Dec. 18, 1984), reprinted in R., vol. 8, tab 13. The appellants appealed the trial court decision to the Texas Court of Appeals in Eastland.

Meanwhile, in October 1984, the clerk of the bankruptcy court notified the appellants and the City that the adversary proceeding had been pending for almost four years without any activity and, therefore, that a status conference would be conducted on November 15. The appellants did not appear at the status conference, and on December 5, 1984, the presiding bankruptcy judge signed an order dismissing the adversary proceeding. On December 20, 1984, the appellants filed a motion for reconsideration.

In August 1985, in an unpublished opinion, the Texas appellate court affirmed the decision of the trial court. *See Tanbark Oil Co. 1978-1, Ltd. v. City of Brady*,

No. 11-85-080-CV (Tex.App.—Eastland, Aug. 22, 1985, writ ref'd n.r.e.), *reprinted in* R. vol. 8, tab 14 [hereinafter Texas Court of Appeals Opinion]. Its justification for doing so, which forms the core of this appeal, is reprinted below.

[The City of Brady's] motion for summary judgment urged that the bankruptcy proceeding operated as *res judicata* of all appellants' claims.

In a single point of error, appellants urge that the trial court erred in granting the summary judgment because at least one genuine issue of material fact still exists. Appellants concede that the trial court was correct in granting the motion with respect to the claim alleging equitable title. They argue, however, that the bankruptcy proceeding left intact their claim for damages resulting from the alleged breach of contract by Brady Gas. Under the Bankruptcy Code, a rejection gives rise to a legal fiction that a breach of the contract occurred immediately prior to the filing of the petition. Thus, a claim is allowable for damages resulting from the breach. However, the claim for damages is to be presented to and determined by the bankruptcy court. Appellants pursued no such claim in the bankruptcy court.

The plan in the instant case was confirmed by the bankruptcy court. An arrangement confirmed by a bankruptcy court has the effect of a judgment rendered by a district court. Any attempt by the parties to relitigate any of the matters that were raised or *could have been raised* therein is barred under the doctrine of *res judicata*. Because appellants could have pursued

the damage claim in the bankruptcy court but failed to do so, the claim is now barred by res judicata.

Id. at 2-3 (citations omitted and emphasis in original). The appellants applied for a writ of error, which the Texas Supreme Court refused to grant, *see Tanbark Oil Co. 1978-1, Ltd. v. City of Brady*, No. C-4779, 29 Tex.Su.Ct. J. 140-41 (Jan. 18, 1986).

While the application for the writ of error was pending before the Texas Supreme Court, the appellants returned to the bankruptcy court and filed a motion asking the bankruptcy court to compel the City of Brady to distribute to them \$1,650,000, the amount in their proof of claim. The appellants reasoned that this was now an allowed claim because the City had not objected to it. *See Bankr. Code § 502(a)*. Based on this same reasoning, the appellants initiated a second adversary proceeding on March 17, 1986, seeking an injunction forbidding Brady Gas and the City from disputing their liability for damages in the state courts.

The City contended, however, that the state judgment barred the appellants from pursuing their claim in the bankruptcy court. The state court had held that the confirmation of the plan discharged the City from liability, and, it maintained, the bankruptcy court was required to give full faith and credit to the state court decision, even if that decision was erroneous. *See 28 U.S.C.A. § 1738* (West 1966). The City also argued that the appellants' proof of claim should not be allowed anyway because Brady Gas had "objected" to the claim when it filed a counterclaim in the initial adversary proceeding, seeking reformation of the farm-out agreement or a declaration that the agreement was null and void.

In August 1986, Bankruptcy Judge R. Glen Ayers issued a memorandum opinion in which he refused to use the state court judgment to bar the appellants' damage claim. *See R.*, vol. 8, tab 15. Judge Ayers first noted that the state court's interpretation of the effect of the confirmation of the plan "was clearly erroneous" because the bankruptcy court had never issued a ruling on the merits of the appellants' proof of claim. *See id.* at 8. He then ruled that the state court did not have jurisdiction to resolve the appellants' damage claim because the bankruptcy court had expressly retained jurisdiction to resolve that claim in Article IX of the Alternate Plan, and, for this reason, the automatic stay was in effect. The judge concluded his opinion by arguing that it would be irrational and inequitable for the bankruptcy court to refuse to address the merits of the appellants' claim based solely on a state court judgment which erroneously assumed that the bankruptcy court had already issued a ruling dismissing the appellants' claim. *See id.* at 9, 10.

In late 1986, the case was transferred to Judge Larry E. Kelly, who ordered the parties to address two questions: (1) did Brady Gas object to the appellants' proof of claim for damages by filing the counterclaim to the first adversary proceeding?: and (2) were the appellants barred by the doctrine of laches from pursuing their proof of claim? This engendered a flurry of motions and responses from both parties regarding the proof of claim, the appellants' second adversary proceeding, and the appellants' motion to reconsider the dismissal of its first adversary proceeding.

On March 24, 1989, Judge Kelly issued a memorandum opinion that overruled Judge Ayers' opinion. *See Memorandum Opinion Resolving Motion for Distribution Under Confirmed Plan of Reorganization, reprinted in R.*, vol. 8, tab 16. Judge Kelly first concluded that the

automatic stay never applied to the City because the City was never a debtor and that, even if it did apply, the stay terminated when the plan was confirmed and the assets of Brady Gas were transferred to the City. *See id.* at 17-18. Next, he held that the bankruptcy court did not have exclusive jurisdiction over the appellants' damage claim; rather, the state court had concurrent jurisdiction with the bankruptcy court. *See id.* at 23. Consequently, he ruled that the state court judgment was entitled to full faith and credit in the bankruptcy court, *see* 28 U.S.C.A. § 1738 (West 1966), and, therefore, that the appellants were barred from pursuing their proof of claim for damages.

That same day, March 24, Judge Kelly entered orders denying the appellants' motion to compel distribution of funds and dismissing the second adversary proceeding. Two weeks later, the judge issued four orders regarding the first adversary proceeding. First, he granted the appellants' motion to reconsider the dismissal of the proceeding; second, he granted their motion to reinstate the proceeding; third, he granted the motion to dismiss Brady Gas's counterclaim; and, finally, he granted the City's motion to dismiss the adversary proceeding. *See* Amended Order Granting Reinstatement of Adversary Case and Thereafter Granting Motion to Dismiss Adversary Case, *reprinted in R.*, vol 8, tab 34. Thus, although the appellants won three of the four battles regarding the first adversary proceeding, they ultimately lost the war.

The appellants sought review in the district court, which issued a brief opinion summarily affirming the bankruptcy court's order. *See Order, reprinted in R.* vol. 8, tab 36. The appellants now ask this court to hold that the bankruptcy judge erred by giving full faith and credit to the state court judgment, thereby dismissing their second adversary proceeding and their motion to compel distribu-

tion. The City cross-appeals, contending that Judge Kelly erred by reconsidering and reinstating the second adversary proceeding even though he ultimately dismissed it.

DISCUSSION

The Full Faith and Credit Act, 28 U.S.C. § 1738, was founded upon article IV, section 1, of the Constitution, *see Roller v. Murray*, 234 U.S. 738, 745, 34 S.Ct. 902, 905, 58 L.Ed. 1570 (1914), and provides that a state's "Acts, records and judicial proceedings ... shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken." Section 1738 directs this federal court to give the Texas judgment the same effect as it would have a Texas court. *See Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518, 525, 106 S.Ct. 768, 772, 88 L.Ed.2d 877 (1986); *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 381, 105 S.Ct. 1327, 1332, 84 L.Ed.2d 274 (1985); *Migra v. Warren City School Dist. Bd. of Education*, 465 U.S. 75, 81, 104 S.Ct. 892, 896, 79 L.Ed.2d 56 (1984); *Kremer v. Chemical Constr. Co.*, 456 U.S. 461, 482, 102 S.Ct. 1883, 1898, 72 L.Ed.2d 262 (1982); *Allen v. McCurry*, 449 U.S. 90, 96, 101 S.Ct. 411, 415, 66 L.Ed.2d 308 (1980).

[2] The bankruptcy court's decision to give full faith and credit to the state court judgment was a conclusion of law, which we review *de novo*, *see In re Fabricators, Inc.*, 926 F.2d 1458, 1464 (5th Cir.1991). The appellants argue that a Texas court would not give full faith and credit to this Texas judgment for three reasons. First, they contend that the Texas court did not have jurisdiction over the appellants' damage claim and that, therefore, a subsequent Texas court would not bar the appellant's damage claim

under the doctrine of res judicata. Second, they assert that even if the Texas court did have jurisdiction over their claim, a fair reading of that court's opinion indicates that it did not intend to resolve the dispute but was referring both parties to the bankruptcy court. Third, they maintain that a Texas court would not apply the doctrine of res judicata without strong public policy reasons for doing so, which, they contend, do not exist in this case. The appellants also argue that giving full faith and credit to the Texas judgment would deprive them of their fifth amendment right to due process.

A. The State Court's Jurisdiction

[3,4] The appellants first contend that the bankruptcy court had exclusive jurisdiction over their damage claim, which arose out of the debtor's decision to reject the farm-out agreement under section 365(g)(1) of the Bankruptcy Code, and that, therefore, the state court did not have jurisdiction. *See Evans v. Dale*, 896 F.2d 975, 978 (5th Cir.1990) (holding that property settlement reached in a divorce proceeding did not bar federal securities claim, over which the federal court had exclusive jurisdiction). Under Texas law, before the doctrine of res judicata will apply, the court rendering the prior judgment must have had jurisdiction over the dispute. *See Salazar v. United States Air Force*, 849 F.2d 1542, 1547 (5th Cir.1988); *Browning v. Placke*, 698 S.W.2d 362, 363 (Tex.1985). Similarly, a federal court does not have to give full faith and credit to a state court judgment if the state court did not have jurisdiction over the subject of the litigation or of the parties before it. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 805, 105 S.Ct. 2965, 2971, 86 L.Ed.2d 628 (1985); *Underwriters Nat'l Assurance Co. v. North Carolina Life and Accident and Health Ins. Guar. Ass'n*, 455 U.S. 691, 704-05, 102 S.Ct. 1357, 1366, 71 L.Ed.2d 558 (1982); *Nevada v. Hall*, 440 U.S. 410, 421, 99 S.Ct. 1182, 1188, 59

L.Ed.2d 416 (1979); *Heiser v. Woodruff*, 327 U.S. 726, 736, 66 S.Ct. 853, 858, 90 L.Ed. 970 (1946). However, the appellants' premise that the state court did not have jurisdiction over their claim is incorrect.

[5] Although the district courts "have original and exclusive jurisdiction of all cases *under* title 11," the district courts do not have "exclusive jurisdiction of all civil proceedings *arising under* title 11 or *arising in or related to* cases under title 11." See 28 U.S.C.A. §§ 1471(a), (b) note (West Supp.1991) (currently codified at 28 U.S.C.A. §§ 1334(a), (b) (West Supp.1991)) (emphasis added). Thus, under section 1471, the only aspect of the bankruptcy proceeding over which the district courts and their bankruptcy units have exclusive jurisdiction is "the bankruptcy petition itself." See *In re Wood*, 825 F.2d 90, 92 (5th Cir.1987). In other matters arising in or related to title 11 cases, unless the Code provides otherwise, state courts have concurrent jurisdiction,¹ and bankruptcy courts are prohibited from relitigating these matters if the state courts have already resolved them. See *Grogan v. Garner*, ____ U.S. ___, 111 S.Ct. 654, 658 n. 11, 112 L.Ed.2d 755 (1991); *Goss v. Goss*, 722 F.2d 599, 602 (10th Cir.1983) (concluding that the doctrine of collateral estoppel barred the bankruptcy court from redetermining the debtor's dischargeability for alimony payments); *Spilman v. Harley*, 656 F.2d 224, 227-28 (6th Cir.1981) (noting that

¹ If a bankruptcy court is asked to make a determination based on state law, it should, and sometimes must, defer to the state court. See 28 U.S.C.A. § 1334(c) (West Supp.1991) (providing that bankruptcy courts may, and sometimes must, abstain from deciding questions of state law); *Callaway v. Benton*, 336 U.S. 132, 142, 69 S.Ct. 435, 441, 93 L.Ed. 553 (1949) (noting "that Congress did not give the bankruptcy court exclusive jurisdiction over all controversies that in some way affect the debtor's estate"); *In re Paso Del Norte Oil Co.*, 755 F.2d 421, 425-426 (5th Cir.1985) (noting that bankruptcy courts should be reluctant to decide questions of state common law).

collateral estoppel prevents a party from relitigating, in the bankruptcy court, factual issues decided by the state court). Consequently, both the Texas court and the bankruptcy court had jurisdiction to resolve the contract dispute between the City and the appellants, and this court is bound by the state judgment. *See Evans*, 896 F.2d at 977-78.

[6,7] Next, the appellants argue that the automatic stay, provided for in section 362(a) of the Code, was in effect at the time the appellants filed their amended complaint in state court and that this deprived the state court of jurisdiction. But the automatic stay terminates when the debtor's property "is no longer property of the estate," *see Bankr.Code § 362(c)(1)*, and the appellants filed their amended complaint in October 1983, over two years after Brady Gas's reorganization plan had been confirmed and its assets had been transferred to the City. *See In re Heron*, 60 B.R. 82, 83-84 (Bankr.W.D.La.1986) (holding that automatic stay no longer applied after the debtor's plan of reorganization had been confirmed). In addition, the reorganization plan explicitly provided that the appellants' claim would be paid after "a court of competent jurisdiction" had determined whether Brady Gas or its successor in interest, the City, was liable. *See First Alternate Plan of Reorganization*, Article IV. Therefore, the Texas court was not interfering with a judgment or decree issued by the bankruptcy court. *Compare Stoll v. Gottlieb*, 305 U.S. 165, 170-171, 59 S.Ct. 134, 136-137, 83 L.Ed. 104 (1938); *Johnson v. Avery*, 414 S.W.2d 441, 443 (Tex.1966).

[8] Finally, the appellants contend that the reorganization plan provided that the bankruptcy court retained jurisdiction to determine their right to damages for the debtor's rejection of the farm-out agreement. The appellants are correct in their factual assertion; the plan

stated that the bankruptcy court would retain jurisdiction to resolve the controversy between Brady Gas and the appellants, *see First Alternate Plan of Reorganization, Article IX(C)*. However, the appellants have drawn an erroneous legal conclusion from that fact. At most, this provision enabled the bankruptcy court to adjudicate the dispute between the City and the appellants even though the debtor's plan was already confirmed;² it did not divest the state court of its concurrent jurisdiction to resolve that dispute.

B. Effectuating the State Court Judgement

[9] Even if the bankruptcy court was required to give full faith and credit to the state judgment because the state had jurisdiction over their claim, the appellants argue that, under Texas law, the bankruptcy court should not have given preclusive effect to the Texas appellate court judgment because a "fair" reading of that judgment indicates that the state court did not believe that it had the power to resolve their damage claim. *See Griffin v. Holiday Inns of Am.*, 496 S.W.2d 535, 538 (Tex. 1973) (noting that a judgment is conclusive only as to matters actually litigated and determined in the first suit); *Gilbert v. Fireside Enters, Inc.*, 611 S.W.2d 869, 872 (Tex.Civ.App.—Dallas 1980, no writ) (same). Although the state court does note that the appellants' "claim for damages is to be presented to and determined by the bankruptcy court," the remainder of that brief opinion belies the appellants' assertion that the state court was simply deferring to the jurisdiction of the

² A reorganization court frequently will insert a clause in a plan that reserves jurisdiction to protect the confirmation decree. *See 5 L. King; Collier on Bankruptcy* ¶ 1142.01[1], at 1142-5 (15th ed. 1991). However, it is unclear whether such clauses are superfluous, i.e., whether they give a bankruptcy court jurisdiction beyond that conferred by statute. *See In re Almarc Corp.*, 94 B.R. 361, 364 (Bankr.E.D.Pa.1988).

bankruptcy court. *See* Texas Court of Appeals Opinion at 2-3, reprinted at page 6 of this opinion.

The state court was under the impression that the appellants had not pursued their claim in the bankruptcy court and that the confirmation of the plan prevented them relitigating their damage claim in a Texas court. A state court's determination that a second action was barred by the doctrine of claim preclusion will bar a third identical action in the federal court. *See Eichman v. Fotomat Corp.*, 880 F.2d 149, 155 (9th Cir.1989). Even if that determination was erroneous, this court, and the appellants, are bound by it. *See Salazar v. United States Air Force*, 849 F.2d 1542, 1543-44, 1547-48 (5th Cir.1988) (holding that a prior Texas judgment compelled the court to require the government "to pay over annuity funds due a veteran for which [the government] had[d] no statutory liability"); *McWilliams v. McWilliams*, 804 F.2d 1400, 1403 (5th Cir.1986) (applying section 1738 and honoring a Texas custody decree even though that decree may have been unconstitutional); *Segrest v. Segrest*, 649 S.W.2d 610, 612 (Tex.) ("That the judgment may have been wrong or premised on a legal principle subsequently overruled does not affect application of *res judicata*."); *cert denied*, 464 U.S. 894, 104 S.Ct. 242, 78 L.Ed.2d 232 (1983).

In a related argument, the appellants assert that it is irrational for this court to preclude them from pursuing their claim in bankruptcy court based on the state court's erroneous conclusion that the bankruptcy court had entered a final judgment against them. One treatise has disparaged such preclusion as "circular":

Modern approaches to finality may lead a second court to apply preclusion on the basis of determinations made in proceedings that have not led to a final judgment in the first court. It is clear

that the preclusion-based judgment in the second court should not then become a basis for preclusion in the first court.

18 C.A. Wright, A. Miller, & E. Cooper, *Federal Practice and Procedure* § 4404, at 18 n. 1 (Supp.1991) (citation omitted). But the appellants have not demonstrated that a Texas court would give less deference to an erroneous determination of finality than to an erroneous determination of other issues that have been decided in a prior proceeding. Consequently, even if the policy behind avoiding circular preclusion were cogent, this court could not impose that policy on Texas.

It has long been established that § 1738 does not allow federal courts to employ their own rules of res judicata in determining the effect of state judgments. Rather, it goes beyond the common law and commands a federal court to accept the rules chosen by the State from which the judgment is taken.

Kremer, 456 U.S. at 481-82, 102 S.Ct. at 1898. *See also McWilliams v. McWilliams*, 804 F.2d 1400, 1402 (5th Cir.1986).

C. Policy Considerations Behind the Doctrine of Res Judicata

The appellants contend that a subsequent Texas court would have rejected the prior state appellate court decision because a Texas court will invoke the doctrine of res judicata only if its application will promote judicial economy, prevent vexatious litigation, prevent double recovery, and promote the stability of decisions. *See Gilbert v. Fireside Enters., Inc.*, 611 S.W.2d 869, 877

(Tex.Civ.App.1980, no writ). In *Gilbert*, the court considered the policy implications of allowing a plaintiff to pursue recovery against a defendant based on two separate causes of action; applying these considerations, it declined to bar an employee from suing her employer for breach of contract after she had lost a suit against her employer for negligence. *See id.* at 877-880.³ In contrast, the appellants were asking the bankruptcy court to award them damages for the alleged breach of the farm-out agreement by Brady Gas, the same cause of action that they launched in the Texas trial court and which subsequently went through every level of the state's judicial system. If a Texas court were faced with this request, the public policy considerations listed above would militate against allowing the appellants to proceed. *See Segrest*, 649 S.W.2d at 612; *Texas Employers Ins. Ass'n v. Tobias*, 740 S.W.2d 1, 2 (Tex.App.—San Antonio 1987, writ denied). *See also Astoria Fed. Sav. & Loan Ass'n v. Solimino*, ____ U.S. ___, 111 S.Ct. 2166, 2169, ____ L.Ed.2d ____ (1991) ("[R]epose is justified on the sound and obvious principle of judicial policy that a losing litigant deserves no rematch after a defeat fairly suffered, in adversarial proceedings, on an issue identical in substance to the one he subsequently seeks to raise."); *Allen v. McCurry*, 449 U.S. 90, 94, 101 S.Ct. 411, 415, 66 L.Ed.2d 308 (1980) (noting that "res judicata and collateral estoppel relieve parties of the cost and vexation of multiple lawsuits, conserve judicial resources, and, by preventing inconsistent decisions, encourage reliance on adjudication").

³ This court has held that *Gilbert* does not accurately state the law of res judicata in Texas. *See Flores v. Edinberg Consol. Indep. School Dist.* 741 F.2d 773, 778 (5th Cir.1984).

D. Due Process

The appellants' final contention is that giving full faith and credit to the state court judgment will deprive them of their right to have their claim adjudicated, thereby depriving them of their fifth amendment right to due process. However, it was the appellants, not the City, who left the bankruptcy court and turned to the state court to seek relief, and they were not deprived of due process simply because the Texas court misconstrued the effect of the confirmation plan, *see Sun Oil Co. v. Wortman*, 486 U.S. 717, 730-31, 108 S.Ct. 2117, 2126, 100 L.Ed.2d 743 (1988) (holding that a state does not violate the Due Process Clause by misconstruing the law of another state). In the absence of any allegation that Texas's procedures were constitutionally deficient, the appellants cannot complain that they have been denied the right to due process. *See Kremer*, 456 U.S. at 483, 102 S.Ct. at 1898.

CONCLUSION

Though erroneous, the state court's determination that confirmation of the debtor's reorganization plan barred the appellants' damage claim against it and its successor in interest is entitled to full faith and credit. Therefore, the bankruptcy court's order dismissing the appellants' claim against Brady Gas and its successor in interest, the City of Brady, is AFFIRMED. Our ruling renders the City's cross appeal against the appellants moot; consequently, its cross-claim is DISMISSED.

APPENDIX B

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS**

AUSTIN DIVISION

FILED
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IN RE:

BRADY, TEXAS, MUNICIPAL
GAS CORPORATION
Debtor

GEORGE O. SANDERS,
GEORGE H. O'BRIEN,
AND TANBARK OIL
COMPANY 1978-1,LTD.
Appellant

CIVIL NO.
A-89-CA-429

VS.

BRADY, TEXAS, MUNICIPAL
GAS CORPORATION AND
CITY OF BRADY, SUCCESSOR-
IN-INTEREST

ORDER

Before the Court is an appeal from an Order of the
Bankruptcy Court brought pursuant to 28 U.S.C. §158(a).
Having considered the briefs of the parties, the Order ap-
pealed from, and the entire record on appeal, the Court is

of the view that the decision of the Bankruptcy Judge should be AFFIRMED.

The Appellant claims the Bankruptcy Court erred in holding that a state court judgment must be given preclusive effect in a bankruptcy proceeding and related adversary proceedings. Appellant also claims that the Bankruptcy Court's application of the doctrine of *res judicata* on the basis of state court action to bar appellant's enforcement of its §502(g) claim under the plan is a denial of due process. The Court finds that the Bankruptcy Court's decision on these issues was correct, and the fact findings supporting that decision were not clearly erroneous. Because these issues are dispositive of this appeal, the Court need not reach the cross-appeal issues.

ACCORDINGLY, the Court hereby adopts the opinion of the Bankruptcy Court and AFFIRMS the decision of the Bankruptcy Court giving full faith and credit to the state court judgment at issue in this cause.

SIGNED AND ENTERED this 27th day of March
1990.

/s/ James R. Nowlin

JAMES R. NOWLIN
UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF TEXAS

FILED
MAR 27 1990

BRADY, TEXAS MUNICIPAL
GAS CORPORATION
DEBTOR

GEORGE O. SANDERS,
GEORGE H. O'BRIEN, AND
TANBARK OIL COMPANY
1978-1, LTD.

APPELLANT

JUDGMENT IN A
CIVIL CASE

VS

BRADY, TEXAS, MUNICIPAL
GAS CORPORATION AND
CITY OF BRADY,
SUCCESSOR-IN-INTEREST

CASE NUMBER:
A-89-CA-429
1-80-BK-00219

- Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

- Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED THE COURT HEREBY ADOPTS THE OPINION OF THE BANKRUPTCY COURT AND AFFIRMS THE DECISION OF THE BANKRUPTCY COURT GIVING FULL FAITH AND CREDIT TO THE STATE COURT JUDGMENT AT ISSUE IN THIS CAUSE.

MARCH 27, 1990

Date

CHARLES W. VAGNER

Clerk

/s/ Linda Clevenger

LINDA CLEVENGER

(By) Deputy Clerk

APPENDIX C

UNITED STATES BANKRUPTCY COURT

WESTERN DISTRICT OF TEXAS

AUSTIN DIVISION

FILED
MARCH 24 89

IN RE:)	
)	
BRADY, TEXAS, MUNICIPAL)	CASE NO.
GAS CORPORATION)	1-80-BK-00219
DEBTOR(S))	
)	
CITY OF BRADY, SUCCESSOR-)	ADVERSARY
IN-INTEREST)	NO. 1-80-0096
)	ADVERSARY
		NO. 1-86-0035

**MEMORANDUM OPINION RESOLVING MOTION
FOR DISTRIBUTION UNDER CONFIRMED PLAN
OF REORGANIZATION.**

This Court has undertaken to review a number of matters pending before it, all of which involve (i) the City of Brady, Texas ("City"), (ii) Brady, Texas, Municipal Gas Corporation ("Debtor" or "BMG"), and (iii) George O. Sanders, George H. O'Brien, and Tanbark Oil Company, 1978-1 Ltd. (jointly referred to hereafter as "Plaintiffs"). It is the intent of this Court to present this Memorandum Opinion and put forth Findings of Fact and Conclusions of Law to satisfy Bankruptcy Rule 7052. The issues presented all appear to be core issues under 28 U.S.C. §157(b)(2)(A), (B), (C), and (O).

I. PROCEDURAL AND FACTUAL HISTORY

1.01 Brady, Texas, Municipal Gas Corporation is a corporation organized under the laws of the State of Texas.

1.02 On or about April 12, 1978, BMG entered into a farmout agreement with George O'Brien ("O'Brien") covering certain oil and gas leases which it owned in Brown County, Texas. Subsequently, O'Brien assigned a portion of his interest in the farmout agreement to Vista Resources, Inc. ("Vista"). Vista then assigned a portion of its interest to Tanbark Oil Company, later known as Tanbark Oil Company 1978-1 Ltd. ("Tanbark").

1.03 Without going through all of the chronological steps during the course of these extended proceedings it is apparent that Vista later assigned the remainder of its interest to Tanbark and thereafter Tanbark and O'Brien assigned their interest to George O. Sanders ("Sanders"). For ease of reference Sanders, as successor-in-interest to Vista, Tanbark and O'Brien will also be referred to as "Plaintiff".

1.04 The City of Brady, Texas, is a Municipal Corporation incorporated under the laws of the State of Texas. As will be more fully described hereafter, it is the successor-in-interest of the Debtor in this case pursuant to a first alternate Plan of Reorganization ("Plan of Reorganization"). The Plan of Reorganization was confirmed by the Bankruptcy Court, the Honorable Bert Thompson presiding, in February 1981.

1.05 On September 13, 1979, Plaintiffs initiated a State Court action against BMG in Cause No. 21,138 in the 35th District Court of Brown County, Texas ("State Court Action"). In general, the facts and causes of action pleaded by Plaintiffs were the following:

- a. BMG and O'Brien entered into an oil and gas farmout agreement;
- b. O'Brien assigned a portion of his interest to Vista which in turn assigned a portion of its interest to Tanbark;
- c. Vista, Tanbark and O'Brien performed all of their obligations on a timely basis;
- d. Vista and Tanbark demanded that O'Brien assign to them the farmout acreage;
- e. On behalf of himself, Vista and Tanbark, O'Brien demanded that BMG assign the farmout acreage;
- f. BMG denied the claim of Vista, Tanbark, and O'Brien to the farmout acreage; and
- g. Vista and Tanbark were prevented from marketing gas from the wells on the farmout acreage and suffered a loss of income.

Based on such pleadings Plaintiffs prayed for a judgment to clear their title, for specific performance to compel BMG to convey title, and for damages.

1.06 On June 20, 1980, BMG filed for relief under Chapter 11 of the Bankruptcy Code in Bankruptcy Case No. 1-80-00219 in the Bankruptcy Court of the Western District of Texas, Austin Division. The action commenced by Plaintiffs in the State Court Action represented a claim against BMG in its bankruptcy case. Code §101(4). In or about December, 1980 Plaintiffs filed a Proof of Claim in the bankruptcy case asserting \$1,650,000.00 in damages. The Proof of Claim has never been formally objected to and never objected to at all except as described hereafter.

1.07 On October 20, 1980, Plaintiffs initiated Adversary Proceeding No. 1-80-0096 in this bankruptcy case

against BMG. The claims in the adversary proceeding were based on the same facts upon which the State Court Action was based: the farmout agreement between Plaintiffs and BMG, the drilling by Plaintiffs of certain gas wells, and the issues relating to proper performance, conveyance of title, and damages.

1.08 In its original answer to Adversary No. 1-80-0096 filed on November 14, 1980, the Debtor denied that the Plaintiffs had completed any producing gas wells, denied the expenses which Plaintiffs alleged they had incurred, and asserted various defenses to any liability. The Debtor also filed an original counterclaim to reform the farmout agreement or to determine that it was null and void.

1.09 On January 12, 1981, BMG filed its First Alternate Plan of Reorganization. Over the objection of the Plaintiffs, the plan was confirmed by court order dated February 4, 1981. Plaintiffs filed a Notice of Appeal which was later dismissed by the District Court by order dated October 1, 1982 for the Plaintiffs' failure to timely prosecute the appeal.

1.10 In pertinent part, the Plan of Reorganization provided as follows:

Article I. Classification of Creditors

Class IV. All claims of all plaintiffs in Cause No. 21,138 styled Vista Resources, Inc. v. Brady, Texas, Municipal Gas Corporation in the 35th Judicial District Court of Brown County, Texas...

Article II. Acquisition of all Assets, Contracts and obligations by the City of Brady.

At the time Brady Gas was created in 1966, two master documents were executed which con-

trolled much of the existence of Brady Gas. One was an ordinance of the City of Brady passed on March 30, 1966, franchising Brady Gas as a natural gas utility. The second was an Indenture Mortgage and Deed of Trust securing the issue of bonds by which Brady Gas was capitalized.

Under both of these instruments, the City of Brady has the right to pay off all of Brady Gas' bond debt and current liabilities. On making such payment, all assets of Brady Gas would transfer to the City and all contracts and obligations of Brady Gas would be assumed by the City.

The City of Brady has proposed to implement the provisions of the instruments named above so as to acquire the assets of and assume the contracts and obligations of Brady Gas. The closing for said transaction was proposed for February 5, 1981.

Brady Gas proposes that its First Alternate Plan of Reorganization to adopt and implement procedures set out in its Franchise Ordinance and Indenture of Mortgage in the following sequences:

(1) All creditors will be paid as set out more fully in Articles III and IV below, said payments to occur no later than February 4, 1981;

(2) On February 5, 1981, the City of Brady shall deposit with Mercantile National Bank at Dallas as escrow agent under a written escrow agreement, a true copy of which is attached hereto, sufficient funds to pay all current liabilities and remaining bonded indebtedness of

Brady Gas as they exist on February 5, 1981;

(3) On February 5, 1981, Brady Gas shall assign to the City of Brady and the City of Brady shall fully assume all contracts and accounts to which Brady Gas is a party.

(4) Beginning on February 5, 1981, and ending as soon as practicable thereafter, Brady Gas shall transfer to the City of Brady all of its assets, accounts, claims, and choses in action; and

(5) At such time as the corporate existence of Brady Gas is no longer needed, the Debtor shall dissolve and cease to exist....

Article

IV. Provisions for Satisfying Claims of Non-Priority Creditors....

Class 4. The claims of all Class 4 creditors shall be paid in an amount equal to and at such time as a court of competent jurisdiction determines that such claims are due and in what amount. (emphasis provided)....

Article V. Executory Contracts.

George O'Brien Farmout Agreement.

Debtor has entered into one certain natural gas drilling contract with George O'Brien. Debtor has and does contend that Mr. O'Brien has failed to perform to terms and provisions of that contract. Without waiving its position that said contract is null, void, and unperformed, *Debtor rejects said contract.*

Without waiving its position that no damages are incurred, Debtor hereby submits any claim for damages under said contract to the Court as a claim under Class 4 over which this Court has jurisdiction. (emphasis provided)....

Article IX. Jurisdiction of the Court.

Subject to Article VI,B, (sic) the Court will retain jurisdiction until this Plan has been fully consummated, including but not limited to the following purposes:

A. The classification of the claim of any creditor and the re-examination of the claims which have been allowed for purposes of determining acceptances at the time of confirmation and the determination of such objections as may be filed to creditor's claims. The failure by the Debtor to object to, or to examine any claim for the purposes of determining acceptances, shall not be deemed to be a waiver of the Debtor's right to object to, or re-examine the claim in whole or in part....

C. Determination of all questions and disputes regarding title to the assets of the estate, and determination of all causes of action, controversies, disputes, or conflicts, whether or not subject to pending action as to the date of confirmation between the Debtor and any other party, including but not limited to, any right of the Debtor to recover assets pursuant to the provisions of title 11, United States Code.

D. The correction of any defect, the curing of any omission or reconciliation of any inconsistency in this Plan for the Order of Confirmation as may

be necessary to carry out the purposes and intent of this Plan.

E. To enforce and interpret the terms and conditions of this Plan....

G. Entry of any order, including injunctions, necessary to enforce the title, rights and powers of the debtor and to impose such limitations, restrictions, terms and conditions of such title, right and powers as this Court may deem necessary.

1.11 From February, 1981, when Plaintiffs approved the Debtor's Plan of Reorganization, to October, 1983, no action was undertaken by Plaintiffs in the State Court Action, the bankruptcy case or in Adversary No. 1-80-0096.

1.12 On October 13, 1983, Plaintiffs filed an amended petition in the State Court Action and joined the City as a Defendant in its capacity as successor-in-interest to BMG under the Plan of Reorganization. The amended petition sought to recover the same relief as had Plaintiffs' original petition.

1.13 On October 22, 1984, the clerk of the court sent a notice to all parties in interest in Adversary No. 1-80-0096 to inform them that "...it is necessary to review those cases and adversary proceedings that have been pending for two or more years. The above-styled and numbered cause has been pending on the Court's docket without apparent activity to date." In fact, the Court's file at that time reflected no formal activity by the Plaintiff for over three years. A status conference was scheduled for November 15, 1984.

1.14 At the status conference no party appeared for

the Plaintiffs. On December 5, 1984 this Court, the Honorable Joseph C. Elliott presiding, signed an Order of Dismissal which recited

“Came on to be heard on the 15th day of November, 1984 the above-entitled and referenced cause for a status report, and the attorney for the Debtor has appeared, the attorney for the Plaintiffs failed to appear. The Court, having considered the fact that the assets of the Debtor have been liquidated pursuant to its Plan, finds that the Plaintiffs' complaint for specific performance is therefore moot and it is

Therefore Ordered that the above-entitled and referenced adversary number be and is hereby dismissed.”

This Order was docketed on December 11, 1984. The Plaintiffs filed a timely Motion For Reconsideration on December 20, 1984.

1.15 Returning to the State Court Action, on October 31, 1984, the City moved for summary judgment, praying that the Plaintiffs take nothing and that the action against the City be dismissed with prejudice.

1.16 On December 5, 1984, Plaintiffs filed Revised Opposing Affidavits to the City's Motion for Summary Judgment, which affidavits included copies of the Chapter 11 Plan of Reorganization, Order Confirming the Plan, the Notice of Appeal filed by Plaintiffs, the Order Dismissing the Appeal, and the Order Dismissing Adversary Proceeding 1-80-0096. Paragraph 12 of the Plaintiffs' affidavit asserted a fact issue which Plaintiffs alleged would prevent the entry of summary judgment, to wit:

12. A fact issue exists as to the determination within the Brady Gas plan of reorganization whether the oil and gas leases and gas storage reservoir contracts assigned to the City of Brady bore the equitable title interest of Plaintiffs at the time of such assignment. A construction of the "farmout agreement" and fact issue raised thereunder will so conclusively determine the nature of Plaintiffs' title.

1.17 In the Second Amended Answer of the City, filed November 30, 1984 in the State Court Action, the City pointed out that BMG had rejected the claims of the Plaintiffs in the confirmed Plan of Reorganization. The City further asserted that the farmout agreement upon which Plaintiffs based their law suit was "expressly not assumed by the City..." Among other defenses the City raised the issues of breach of contract, clerical error, vagueness, ambiguity, mutual mistake, the statute of frauds and the statute of limitations.

1.18 On December 14, 1984, the 35th District Court of Brown County, Texas ("State District Courts") signed an order dropping Vista and Tanbark as Plaintiffs in the State Court Action and adding Sanders and Tanbark Oil Company 1978-1 Ltd.

1.19 On December 14, 1984 the State District Court granted the City's motion for summary judgment and ordered severance in an order styled "Summary Judgment in Favor of Defendant City of Brady, Texas and Order of Severence." The Court's order did not indicate the specific grounds for granting the summary judgment. It merely stated:

"...The court having considered the pleadings and the summary judgment proofs and

the court having found an absence of any genuine issue of material fact concerning the question of liability of the City of Brady, Texas, and that summary judgment should be rendered for Defendant City of Brady, Texas, it is accordingly

ORDERED, ADJUDGED AND DECREED that Plaintiffs Tanbark Oil Company and George O'Brien take nothing of Defendant City of Brady, Texas and that said Defendant go hence with his cost without day...."

The Court also severed the City from the State Court Action and set up a separate file for the severed action so that the summary judgment would become final and therefore an appealable order.

1.20 The Plaintiffs did timely appeal the State Court summary judgment ruling to the Eleventh Court of Appeals. On August 22, 1985, that court affirmed the take-nothing judgment. In its opinion the Court stated in pertinent part:

"In a single point of error, Appellants urge that the trial court erred in granting the summary judgment because at least one genuine issue of material fact still exists. Appellants concede that the trial court was correct in granting the motion with respect to the claim alleging equitable title. They argue, however, that the bankruptcy proceeding left intact their claim for damages resulting from the alleged breach of contract by Brady Gas. Under the Bankruptcy Code, a rejection gives rise to a legal fiction that a breach of the contract occurred immediately prior to the filing of the petition. 11 U.S.C.A. Sec. 365(g)(1) (1979). Thus, a claim is allowable for damages resulting from the breach. However, the claim

for damages is to be presented to and determined by the bankruptcy court. *In re Davies*, 27 B.R. 898 (Bankr. E.D. N.Y. 1983). Appellants pursued no such claim in the bankruptcy court.

The plan in the instant case was confirmed by the bankruptcy court. An arrangement confirmed by a bankruptcy court has the effect of a judgment rendered by a district court. Any attempt by the parties to relitigate any of the matters that were raised *or could have been raised* therein is barred under the doctrine *res judicata*. *Miller v. Meinhard-Commercial Corporation*, 462 F.2d 358 (5th Cir. 1972); *In re Union League Club of Chicago*, 203 F.2d 381 (7th Cir. 1953). Because appellants could have pursued the damage claim in the bankruptcy court but failed to do so, the claim is now barred by *res judicata*. The point of error is overruled. The judgment of the trial court is affirmed."

The assumption by the appellate court that all claims had been disposed of in the bankruptcy court or that plaintiffs were not pursuing their claim was "not correct." Adversary no. 1-80-0096 represented the claim in question and it was and is still pending.

1.21 The State Court appeal was then taken in November 1985 by Plaintiffs to the Supreme Court of the State of Texas by application for writ of error. On January 15, 1986, the Texas Supreme Court refused the writ, effectively leaving the opinion of the Eleventh Court of Appeals as a final order, affirming the trial court's granting of the City's motion for summary judgment.

1.22 While the Application for Writ of Error was pending before the Texas Supreme Court, Plaintiffs filed new pleadings in the Bankruptcy Court. On December 11, 1985,

Plaintiffs filed a motion in the bankruptcy case for an order compelling the Debtor and its successor-in-interest, the City, to make distribution on Plaintiffs' proof of claim. Also, on March 17, 1986, Plaintiffs initiated a new adversary proceeding, No. 1-86-0035 by filing a complaint for injunctive relief. This complaint recites the procedural history and rulings in the State Court Action, then asserts that the Plaintiffs' proof of claim for damages from the rejection of the farmout agreement in Debtor's Plan of Reorganization is an "allowed claim" because no formal objection to it had ever been asserted. Plaintiffs argue that the claim has therefore been "allowed" and that the City, as successor-in-interest, should be compelled to pay it. Plaintiffs sought an order of the bankruptcy court to enjoin BMG and the City from relitigating in the State Court the existence or validity of Plaintiffs' claim or the City's liability and obligations under the Plan. The City's response was filed on June 2, 1986. It asserted that the answer of BMG in Adversary No. 1-80-0096 was an objection to the Plaintiffs' proof of claim and that the proof of claim is therefore *not* an allowed claim under Code §502. Further, the City asserted that the final order in the State Court Action barred any further effort by Plaintiffs to litigate their claim.

1.23 After receiving briefs, this Court, the Honorable R. Glen Ayers presiding, issued in bankruptcy case No. 1-80-00219 its Memorandum Opinion on the Plaintiff's Motion to Compel Distribution. ("Memorandum Opinion"). In pertinent part the Memorandum Opinion concluded that the Plan of Reorganization in its language retaining jurisdiction in the bankruptcy court to determine claims disputes "...can only mean that the *stay remained in effect* and that this Court had and has *exclusive jurisdiction* in this case. The rulings of the state courts are therefore void or voidable." (emphasis added).

The Court's Memorandum Opinion also stated that:

"The State Court, however, as I have shown did not have jurisdiction. The stay was in effect:

(1) The Plan itself expressly reserved litigation of this claim in this Court;

(2) The Claim was and is still pending, either by virtue of the proof of claim or by the existence of the adversary proceeding."

Clearly frustrated, the Court also stated "Finally, it would be inequitable to let the City propose a plan treating this claim, reserve treatment of the claim to this Court, and then argue that the claim has been finally determined as disallowed — *when it had not been treated at all* — in order to persuade a state court that a final determination had been made and was *res judicata*. For the reasons stated above, the response of the City of Brady is overruled and a hearing will be set on the motion of the Movants concerning allowance of the claims and for distribution of those claims."

1.24 Subsequent to the Memorandum Opinion of August, 1986, the following pleadings have been filed:

A. Adversary No. 1-86-0035

(1) 6-30-87 — Motion to Dismiss Adversary Proceeding, filed by the City.

~~(2)~~ 6-30-87 — Motion For Summary Judgment filed by the City.

(3) 8-21-87 — Response in Opposition to the City of Brady, Texas' Motion for Summary Judgment filed by Plaintiffs.

(4) 7-14-88 — Order Setting Hearing for August 25, 1988.

B. Adversary No. 1-80-0096

(1) 6-29-87 — Amended Motion for Reconsideration and Motion to Reinstate Adversary; and Motion for Entry of Order of Dismissal of Counterclaim for Want of Prosecution, or Alternatively For Latches filed by Plaintiffs.

(2) 6-30-87 — Defendant's Motion to Dismiss or Deny Motion For Reconsideration filed by the City.

(3) 6-30-87 — Motion of the City of Brady, Texas to Appear and Be Heard With Regard to the Motion For Reconsideration.

(4) 7-14-87 — Response of the City of Brady to Amended Motion for Reconsideration; and

(5) 7-14-88 — Order Setting Hearing for August 25, 1988.

C. Bankruptcy Case No. 1-80-00219

(1) 6-29-87 — Plaintiffs' Motion For Summary Judgment Against City of Brady, Texas.

(2) 6-30-87 — Motion of the City of Brady, Texas to Dismiss Motion For Order Compelling Debtor and its Successor-In-Interest the City of Brady, Texas to Make Distribution Upon Movants Alleged Claim pursuant to confirmed Plan of Reorganization.

(3) 7-14-87 — Response of City of Brady, Texas in opposition to Motion for Partial Summary Judgment Against City of Brady, Texas.

(4) 7-14-88 — Order Setting Hearing for August 25, 1988.

II. ISSUES PRESENTED

2.01 In the bankruptcy case itself, the court has before it the Plaintiffs' Motion For Order to Compel Distribution and its Motion For Partial Summary Judgment.

2.02 In adversary No. 1-80-0096 is pending the Motion to Reinstate and if reinstated, the Plaintiffs' Motion to Dismiss BMG's original counterclaim and the countervailing motion of the City to dismiss the adversary proceeding itself.

2.03 In Adversary No. 1-86-0035 is pending the City's Motion to Dismiss.

Fundamentally, all of these matters require this Court to determine whether the State Court Action and resulting order dismissing the Plaintiffs' claim should be given preclusive effect. If so, the City's Motions to Dismiss

both adversary proceedings with prejudice would be granted and Plaintiffs' Motion to Compel Distribution would be denied. If preclusive effect is denied, then (i) the City's motions would be denied, (ii) this Court would rule on the Plaintiffs' Motion for Partial Summary Judgment in the bankruptcy case and (iii) the two adversary proceedings would be set for trial on the merits.

III. DISCUSSION

3.01 The obvious starting point is the Memorandum Opinion of August, 1986 which essentially stated that the orders entered in the State Court Action were void or voidable. The basis of that ruling, as stated therein, was that the automatic stay was in effect and that the bankruptcy court had retained exclusive jurisdiction over the claims at issue between the parties. Those assumptions lead the bankruptcy court to determine that the state courts had no jurisdiction so their judgments were therefore void, or at worst, voidable. This Court has determined that the Memorandum Opinion is incorrect.

3.02 Code §3.62(a) provides for an automatic stay upon the filing of a petition. It provides for a broad stay of litigation, lien enforcements and other actions, judicial or otherwise, which would affect or interfere with property of the estate, property of the Debtor, or property in custody of the estate.

3.03 Code §3.62(c) provides for the duration of the stay as follows:

"Except as provided in subsections (d), (e) and (f) of this section —

(1) the stay of an act against property of the

estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of —

(A) the time the case is closed;

(B) the time the case is dismissed; or

(C) if the case is a case under Chapter 7 of this title concerning an individual or a case under Chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied."

3.04 The facts in this case show that all of BMG's property was transferred to the City of Brady once its Plan was confirmed. The automatic stay as to property of the estate therefore was terminated before the state court rulings complained of.

3.05 The automatic stay never applied to the City of Brady, Texas. It was never a debtor. See generally, *Wedgeworth v. Fiberboard Corp.*, 706 F.2d 541, 544 (5th Cir. 1983); *Gatx Aircraft Corp. v. M/V Courtney Leigh*, 768 F.2d 711 (5th Cir. 1985).

3.06 On the issue of exclusive jurisdiction to determine claims, this Court also believes the Memorandum Opinion is in error. When the Plan of Reorganization was filed and confirmed, the applicable statute granting jurisdiction over bankruptcy cases was 28 U.S.C. 1471(a), (b) and (c):

"(a) except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

(c) The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all of the jurisdiction conferred by this section on district courts."

3.07 Because of constitutional infirmities with subsection (c) the U.S. Supreme Court, seeing no logical basis for severing subsection (c) from the remaining portions of 28 U.S.C. §1471, determined that the entire section was unconstitutional. See Northern Pipeline Construction Co. v. Marathon Pipeline Co., 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). The Supreme Court decision was stayed however until October 4, 1982 to afford Congress an opportunity to amend the bankruptcy laws. The decision therefore does not affect the validity of the bankruptcy court's order confirming the Plan of Reorganization at issue in this case.

3.08 Congress did amend the jurisdictional ground of authority in 1984 by enacting 28 U.S.C. §1334 with subsections (a) through (d). Subsection (a) and (b) are identical to the grant of authority found in former 28 U.S.C. §1471(a) and (b). Congress also added 28 U.S.C. §157 to establish the jurisdiction of the bankruptcy court over bankruptcy matters in an attempt to cure the constitutional infirmities found in former 28 U.S.C. §1471(c).

3.09 This Circuit has rendered a recent opinion, *In the Matter of Wood*, 825 F.2d 90 (1987) which gives some guidance in this area. In that case two medical doctors had a dispute over their percentage of ownership of stock in a professional medical clinic and over the propriety of certain distributions made from the clinic. One doctor filed bankruptcy. The non-debtor doctor filed an adversary proceeding to determine ownership in the clinic and to seek recovery of damages for wrongful appropriations allegedly taken by the Debtor-doctor. Debtor's motion to dismiss the adversary for lack of jurisdiction was denied by the bankruptcy court but that opinion was reversed and the motion to dismiss was granted by the district court. On further appeal, the Fifth Circuit first recognized that 28 U.S.C. §1334(a) giving jurisdiction over "cases," refers to the bankruptcy petition itself "over which district courts (and their bankruptcy units) have original *and* exclusive jurisdiction." The concern in the case at hand however was "with the other *proceedings* listed in subsection 1334(b) over which the district court's have original, *but not exclusive* jurisdiction." (emphasis added). The Circuit then stated:

"There is almost no legislative history to guide us in interpreting the 1984 Act. Subsection 1334(b) however, was taken verbatim from subsection 1471(b) of the 1978 Act. The legislative history and judicial interpretations of that act are instructive.

Legislative history indicates that the phrase 'arising under title 11, or arising in or related to cases under title 11' was meant, not to distinguish between different matters, but to identify collectively a broad range of matters subject to the bankruptcy jurisdiction of federal courts."

Wood at 92.

3.10 The Wood decision is important for the analysis it makes of subject matter jurisdiction. Additionally, it provides some useful analysis for the case at hand because it discusses a non-debtor's state law claim against a bankrupt. In Wood, the non-debtor plaintiff argued that his action was an action against the estate and therefore a core proceeding. The Fifth Circuit disagreed.

"In determining the nature of a proceeding for purposes of determining core status, the court must look to both the form and the substance of the proceeding.¹ The form of this action is not that of a 'claim' as that term is used in bankruptcy law. A claim against the estate is instituted by filing a proof of claim as provided by the bankruptcy rules. The filing of the proof invokes the special rules of bankruptcy concerning objections to the claim, estimation of the claim for allowance purposes, and the rights of the claimant to vote on the proposed distribution. Understood in this sense, a claim filed against the estate is a core proceeding because it could arise only in the context of bankruptcy. *Of course, the state law right underlying the claim could be enforced in a state court proceeding absent the bankruptcy, but the nature of the state court proceeding would be different from the nature of the proceeding following the filing of a proof of claim.*" (emphasis added).

3.11 The dispute made the basis of the Plaintiffs' claim, as evidenced by the proof of claim filed in this bankruptcy case and the cause of action asserted in adver-

¹ Citing *In Re World Financial Services, Inc.*, 64 B.R. 980, 984-87 (Bankr. S.D. Ca. 1986).

sary proceeding 1-80-0096, is based on a contract agreement involving state oil and gas law. There is no evidence of any independent federal issue. Much has been made of a federal issue because of 11 U.S.C. §502(g)² and 365(g).³

3.12 However, the facts show that the farmout agreement was breached, if at all, pre-petition. The claim existed before BMG filed bankruptcy and in fact, the litigation over the claim was instituted in the State Court Action before BMG filed bankruptcy. The formal rejection by BMG in its Plan of Reorganization, at article V, along with Code §365(g)(1) merely kept the claim as a pre-petition claim for damages for breach of contract. Assumption would necessarily have required a cure of the default, if any, and a subsequent rejection thereafter would have created a post-petition claim. (Code §365(g)(2)) The §502(g) claim is merely the damages asserted by Plaintiff as evidenced by the State Court Action. There are no new rights or liabilities created or governed by federal law at issue. Therefore, although the bankruptcy court would have jurisdiction over the Plaintiffs claim, it is concurrent jurisdiction with the state courts. Even if the Plan of Reorganization had attempted to confer exclusive jurisdiction on the bankruptcy court, this attempt would be invalid

² 502(g) provides: "A claim arising from the rejection, under §365 of this title or under a plan under chapter...11...of this title of an executory contract...that has not been assumed shall be determined, and shall be allowed under subsection (a), (b) or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

³ Code Section 365(g) provides: "Except as provided in subsection (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease —

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter...11... of this title, immediately before the date of the filing of the petition...".

as private parties have no power to confer jurisdiction which does not exist.

3.13 Having determined that the Memorandum Opinion of August 1986 was incorrect as to the effect of the automatic stay and the jurisdiction of the state courts, this Court determines that it is not bound by the Memorandum Opinion in this case. See generally, *White v. Murtha*, 377 F.2d 428 (5th Cir. 1967); *Golman v. Tesoro Drilling Corp.*, 700 F.2d 249 (5th Cir. 1983); *Abshire v. Seacoast Products, Inc.*, 668 F.2d 832 (5th Cir. 1982); and *In re Peters*, B.R. 401 (Bankr. W.D. 401, 412) (Bankr. W.D. Tex. 1988).

3.14 Since the State Court had concurrent jurisdiction with this Court and was unimpeded by the automatic stay, the issue squarely presented is the effect that this Court should give to the trial court's summary judgment in favor of the City. 28 U.S.C. §1738, the Full Faith and Credit Act, provides in relevant part:

"The records in judicial proceedings of any court of any...state...or copies thereof, shall be proved or admitted in other courts within the U.S....

Such acts, records and judicial proceedings...shall have the same full faith and credit in every court within the U.S....as they have by law or usage in the courts of such state...from which they are taken."

3.15 The Full Faith and Credit statute therefore requires a federal court to refer to the preclusion law of the state in which judgment was rendered:

"It has long been established that §1738 does not allow federal courts to employ their own

rules of res judicata in determining the effect of state judgments. Rather, it goes beyond the common law and commends a federal court to accept the rules chosen by the state from which the judgment is taken."

Kramer v. Chemical Construction Corp., 456 U.S. 461, 481-482, 102 S.Ct. 1883, 1898, 72 L.Ed.2d 262 (1982).

3.16 This Court recognizes that the Plaintiffs, the Debtor and the City of Brady, Texas as successor-in-interest to the Debtor, have never actually presented live witnesses to any court. The entire history of this conflict represents occasional flurries of procedural fisticuffs, followed by long periods of resting between rounds.

(a) The State Court Action was commenced on September 19, 1979. Plaintiffs' First Amended Original Petition was the next real action in that case and it was filed in October, 1983. It was not until October, 1984 that the City filed a Motion For Summary Judgment in the State Courat Action and the appellate trail resulted thereafter.

(b) In Adversary Proceeding No. 1-80-0096 the complaint was filed in October, 1980 closely followed by the answer and counterclaim in November, 1980. Other than a suggestion of non-joiner filed by the Debtor in November, 1981, the next action was not undertaken until the clerk of the court set a status hearing for December, 1984. At that hearing no one appeared for Plaintiff and the adversary proceeding was dismissed. Although the Motion for Reconsideration was timely filed, no request for hearing was made and it was not until May 1987 that the City filed its Motion to Dismiss which is currently before the Court.

(c) In the Chapter 11 case matters progressed rapidly to the Order Confirming the Plan of Reorganization. That

Order was appealed in February, 1981, an exension of time in which to file appellate briefs was entered and then nothing further was done until the district court dismissed the appeal for want of prosecution in November, 1982.

(d) Adversary Proceeding 1-86-0035 was commenced in April, 1986 and it languished until the June, 1987 Motion for Summary Judgment and Motion to Dismiss were filed by the City.

All in all, this represents a pretty lackadaisical effort by parties allegedly ready to litigate their controversies.

3.17 This Court believes that the bankruptcy court's Memorandum Opinion finding that the state court judgment was not entitled to claim preclusive effect was in error. In Parsons Steel, Inc. v. First Alabama Bank, 474 U.S. 518, 106 S.Ct. 768, 772, 88 L.Ed.2d 877 (1986) the Supreme Court affirmed its earlier decisions in Marrese v. American Academy of Orthopedic Surgeons, 470 U.S. 383, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985), and Migra v. Warren City School District Board of Education, 465 U.S. 75, 104 S.Ct. 892, 79 L.Ed.2d 56 (1984), holding that under full faith and credit a federal court must give the same preclusive effect to a state court judgment as another court of that state would give.

3.18 Under the Full Faith and Credit Act, this Court, as a federal court, must apply the Texas law of res judicata. See, McWilliams v. McWilliams, 804 F.2d 1400 (5th Cir. 1986). Under Texas law, Plaintiffs are precluded under principles of res judicata from twice seeking judgment on the same cause of action. This preclusion is effective regardless of what issues are actually determined. In Segrest v. Segrest, 649 S.W.2d 610, 612 (Tex. 1983), the Texas Supreme Court held that "final judgment settles not

only issues actually litigated, but also any issues that could have been litigated." See also *Miller Brewing Co. v. Fort Worth Distributing Co.*, 781 F.2d 494, 498-99 (5th Cir. 1986); and *Trahan v. Trahan*, 626 S.W.2d 485, 487-88 (Tex. 1981).

As stated by the Texas Supreme Court: "The rule of res judicata rests upon the policy of protecting a party from being twice vexed for the same cause, together with that of achieving judicial economy and precluding a party who has had a fair trial from relitigating the same issue." *Benson v. Wanda Petroleum Co.*, 468 S.W. 2d 361, 363 (Tex. 1971). The fact that the State Supreme Court has ruled on a state court action obligates all state courts to recognize the lower court's judgment. See *Texas Employees Insurance Association v. Tobias*, 740 S.W.2d 1, 2 (Tex. App. - San Antonio 1986, writ refused). The Court of Appeals of Texas in San Antonio felt compelled to follow the decision of the Texas Supreme Court, although it did not agree with the decision:

"The question of Ms. Tobias' right to reversionary benefits was clearly once before resolved against her by the Eastland Court, and having been so, further litigation of the issue should have been barred by res judicata. That opinion and its judgment were nevertheless approved as being without error by our Supreme Court. And while we might be inclined to now disapprove it or even overrule it, the judgment emanating therefrom is now a final judgment and is itself subject to a claim of res judicata."

Citing *Segrest v. Segrest*, 649 S.W.2d 610 (Tex. 1983); *Trahan v. Trahan*, 626 S.W.2d 485 (Tex. 1981).

3.19 Whether the State Court Action correctly

decided the liability question is not an issue before this Court because it does not alter the res judicata consequences in subsequent proceedings. In Segrest, the Supreme Court held:

"That the judgment may have been wrong or premised on a legal principle subsequently overruled does not affect the application of res judicata."

Segrest at 612. Also, Texas law recognizes that when a federal court and a state court have concurrent jurisdiction, the first court to reach a decision will be entitled to have its decision receive res judicata effect. Anderson v. young, 101 S.W.2d 798 (Tex. 1937); In re United Services Life Insurance Co. v. DeLaney, 396 S.W.2d 855, 863 (Tex. 1965).

3.20 Although the Plaintiffs keep asserting that the state courts were incorrect in their factual assumptions which led to the summary judgment in favor of the City, there are no detailed findings at the trial court level to evidence the basis of that Court's decision. That Court read the pleadings and affidavits which addressed a number of issues other than the finality of the bankruptcy court order on the Plan of Reorganization and then found in favor of the City. Even so, the correctness of the State Court judgment is irrelevant. The Fifth Circuit recently made this principle clear in Salazar v. United States Air Force, 849 F.2d 1542 (5th Cir. 1988). In Salazar, the Fifth Circuit used "wrong", "dead wrong", "plainly wrong", and "grossly wrong" in describing a Texas judgment. However, because the Texas court had jurisdiction to decide the issue, the Fifth Circuit ruled that it had to give full faith and credit to the judgment:

"We reemphasize that the correctness of the Texas court's decision not only escapes us, we find it totally unacceptable. That holding could have been questioned other than abstractly had the judgment been attacked directly, by appeal to the Texas appellate courts. We have no doubt as to the probable result of such a direct attack. We have even less doubt that no matter how plainly wrong the Texas district court's judgment might on direct appeal have been shown to be, that possibility has no bearing on its enforcement. *Fehlhaber v. Fehlhaber*, 681 F.2d 1015, 1021, n.6 (5th Cir. 1982). Its enforcement is all that is before us here.

The Texas district court had jurisdiction to decide whether the obligation at issue was indeed one for child support. Moreover, it adequately and correctly recited in the formal judgment this basis for its jurisdiction. Under §1738, we can inquire no further. No matter how intrinsically erroneous this state district court's unappealed judgment that it *was* an obligation for child support, that judgment is conclusively binding on the parties in this case, including the Air Force."

Salazar, 849 F.2d at 1548.

CONCLUSION

This Court concludes that no automatic stay prevented the state court from determining the issues between these parties. This Court also concludes that there was no exclusive jurisdiction in the bankruptcy court and therefore the state courts had concurrent jurisdiction. Based on 28 U.S.C. §1738 and the case law decisions, this Court cannot review the correctness of the summary judgment in favor of the City of Brady and must accord full

faith and credit to that summary judgment. This Court will (i) enter a separate Order in the bankruptcy case denying the Motion of Plaintiffs to compel distribution of funds under the Plan of Reorganization; (ii) enter a separate Order incorporating the above Findings of Fact and Conclusions of Law that will grant the Motion by the City to dismiss adversary proceeding 1-86-0035; and (iii) enter a separate Order incorporating the above Findings of Fact and Conclusions of Law denying Plaintiff's Motion to Reinstate Adversary Proceeding 1-80-0096 and denying as moot the City's Motion to Dismiss that adversary proceeding.

Signed this 24 day of March, 1989.

/s/ Larry E. Kelly

Larry E. Kelly
Chief U.S. Bankruptcy Judge

APPENDIX D

**UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION**

**FILED
AUG 6 1986**

IN RE:)	
BRADY, TEXAS MUNICIPAL)	1-80-00219
GAS CORP.,)	CHAPTER 11
DEBTOR)	

MEMORANDUM OPINION

On June 20, 1980, Brady Municipal Gas Corp. ("Brady Gas") filed a petition under Chapter 11. At the time of the filing, a state court law suit was pending in which three plaintiffs, including Tanbark Oil Co. and George H. O'Brien, Movants in this proceeding, alleged causes of action arising under a "farm-out" agreement. (The facts of that suit are not relevant in this proceeding). That state court suit was stayed, but O'Brien and the other plaintiff filed an adversary proceeding in this case alleging the same cause of action. Apparently, the adversary proceeding has never been dismissed. O'Brien and Tanbark also filed a Proof of Claim in this case for \$1,650,000.00.

A true copy of the original, I
certify.

Charles W. Vagner
Clerk, U.S. District Court

By: /s/ Illegible

Deputy

Jul 10 1987

On February 4, 1981, this Court, Judge Bert W. Thompson presiding, confirmed the Brady Gas Plan of Reorganization ("Plan"). Movant's claim was treated by the following provision:

ARTICLE V

Executory Contracts

George O'Brien Farmout Agreement

Debtor has entered into one certain natural gas drilling contract with George O'Brien. Debtor has and does contend that Mr. O'Brien has failed to perform to terms and provisions of that contract.

Without waiving its position that said contract is null, void, and unperformed, Debtor rejects said contract.

Without waiving its position that no damages are incurred, Debtor hereby submits any claims for damages under said contract to the Court as a claim under Class 4 over which this Court has jurisdiction.

No provision in the Plan sets a time during which objections to claims must be filed. Under the terms of the Plan, the City of Brady assumed all obligations of Brady Gas. (Article II). The claim of O'Brien and Tanbark was to be paid "at such time as a court of competent jurisdiction determines that such claims are due and in what amount." (Article IV).

At confirmation, Movants' objections were overruled; they appealed; the appeal was dismissed for failure

to prosecute on October 4, 1982. No other proceedings before this Court have taken place. No objection to claim has been filed; the adversary is still pending.

Silence in this forum did not reveal the true state of affairs. O'Brien, Vista and Tanbark went back to state court and revived the dormant state court proceeding. Judge R.T. Pfeiffer, on December 14, 1984, granted summary judgment after considering a pleading filed by the City of Brady. The City alleged that the claims under the farm-out agreement, an executory contract, had been affected by the Order of Confirmation. Brady alleged that the Movants' state court cause of action was barred under the doctrine of *res judicata*. Brady seems to have argued—unless it meant to mislead the state trial judge—that claims based on the farm-out agreement were barred—the farm-out agreement having been rejected in the confirmed plan. Brady did argue that the Plan "rejected [movants'] claim," but the Plan did not do so. It rejected the contract and left adjudication of *bankruptcy claims* up to "a court of competent jurisdiction." I think it only fair to presume this interpretation, because two attorneys such as Samuel D. McDaniel and Milton Bankston would not have deliberately mislead Judge Pfeiffer.

O'Brien and Tanbark appealed. (By this date, Vista was defunct and had assigned its claims to Tanbark). In an unpublished opinion, the Texas 11th Court of Appeals, Eastland, sustained the trial court. A subsequent appeal to the Texas Supreme Court was unsuccessful.

The 11th Court of Appeals decision should also be carefully considered. The 11th Court of Appeals correctly focused upon the obvious issue but made a mistake of fact and law:

In a single point of error, appellants urge that the trial court erred in granting the summary judgment because at least one genuine issue of material fact still exists. Appellants concede that the trial court was correct in granting the motion with respect to the claim alleging equitable title. They argue, however, that the bankruptcy proceeding left intact their claim for damages resulting from the alleged breach of contract by Brady Gas. Under the Bankruptcy Code, a rejecting gives rise to a legal fiction that a breach of the contract occurred immediately prior to the filing of the petition. 11 U.S.C.A. sec. 365(g)(1)(1979). Thus, a claim is allowable for damages resulting from the breach. However, the claim for damages is to be presented to and determined by the bankruptcy court. *In re Davies*, 27 B.R. 898 (Bankr. E.D.N.Y. 1983). Appellants pursued no such claim in the bankruptcy court.

Tanbark Oil Co. 1978-1, LTD, et al v. City of Brady, No. 11-85-080-CV at 2 (Assoc. Justice R. Brown, Aug. 22, 1985).

The last sentence finding that Movants had not pursued the claim for damages is clearly erroneous. A Proof of Claim and adversary proceeding were on file. Most importantly, the Proof of Claim had never (*and has never*) been objected to by Debtor or its successor, the City. Objections to claims must be filed by a debtor or other party in interest. 11 U.S.C. §502(a). No such objection has ever been filed.

Still, the holding of the 11th Court of Appeals is correct as far as it goes:

The plan in the instant case was confirmed by the bankruptcy court. An arrangement con-

firmed by a bankruptcy court has the effect of a judgment rendered by a district court. Any attempt by the parties to relitigate any of the matters that were raised or *could have been raised* therein is barred under the doctrine of *res judicata*. *Miller v. Meinhard-Commercial Corporation*, 462 F.2d 358 (5th Cir. 1972); *In re Union League Club of Chicago*, 203 F.2d 381 (7th Cir. 1953). Because appellants could have pursued the damage claim in the bankruptcy court but failed to do so, the claim is now barred by *res judicata*. The point of error is overruled.

Id. at 2-3.

The assumption of the Court of Appeals and District Court, that *all* claims had been disposed of in this forum, was clearly incorrect.

In its present posture, this case seems to be very complicated. There is a *final* bankruptcy plan (and order) and a final judgment of a state court, all allegedly dealing with the same issues and thus raising question of comity, preclusion, and so forth. I would suggest that this case is much simpler.

1. Does the Bankruptcy Court have Exclusive Jurisdiction?

If the answer to this question were "yes," the result would be clear. Unfortunately, the answer is unclear. Until the order confirming the Plan was entered, the bankruptcy court had exclusive jurisdiction because of the automatic stay under 11 U.S.C. §362(a) unless it had abstained under 28 U.S.C. §1334 or released the stay under 11 U.S.C. §362. It could have abstained - a state court proceeding had been filed pre-petition, and the issues were purely ones of state

law. 28 U.S.C. §1334. It could have released the stay under §362 to allow liquidation of claims ("for cause"). 11 U.S.C. §362(d)(1). This Court did neither.

However, once the plan was confirmed and the assets transferred to a non-debtor, the stay may well have terminated under §362(c)(1) (stay terminates when property transferred from the estate) for all property was transferred to the City of Brady under the plan.

Nevertheless, the confirmed Plan provided that the Bankruptcy Court retain jurisdiction of:

- (1) Claims litigation (Article IX A.), and;
- (2) Determinations of Title to assets (Article IX C.).

I am left, then, with a situation in which this Court clearly had jurisdiction of the claims dispute (assuming that the finality of the order confirming the Plan and the Plan itself answer and are *res judicata* as to all questions of title to the assets subject to the Movants' farm-out agreement or contract).

With jurisdiction still in this Court, and the stay arguably still in effect, Movants went back to state court and sought to assert a damage claim against the City under the Plan. No party raised the issue of the stay under 11 U.S.C. §362.

All of this would indicate that the stay was in effect and that the judgment by the trial court and appeals court were, at the very best, voidable. *Compare In re Oliver*, 38 B.R. 245 (Bankr. D. Minn. 1984) (voidable) with *In re Mulley*, 41 B.R. 799 (Bankr. N.D.N.Y. 1984) (void).

What complicates all of this is the assignment of the Movants' claims litigation in the Plan to a "court of competent jurisdiction." Article IV class 4. This could be deemed a waiver or release of stay. *But*, and I underline "but", at Article V, dealing specifically with the Movants' claim, the Plan provides:

Without waiving its position that no damages are incurred, Debtor hereby submits any claims for damages under said contract [O'Brien farm-out] to the Court [i.e. this Court]. As a claim under Class 4 over which this Court has jurisdiction.

This provision, coupled with the retention of jurisdiction over claims disputes, can only mean that the stay remained in effect and that this Court had and has exclusive jurisdiction in this case. The rulings of the state courts are therefore void or voidable.

2. Is continued exercise of jurisdiction barred by preclusion?

The Supreme of the United States in *First Alabama Bank v. Herbert*, 474 U.S., 88 L.Ed 2d 877 (1986), has held that:

[T]he Full Faith and Credit Act requires that federal courts give the state court judgment, and particularly the state court's resolution of the res judicata issue, the same preclusive effect it would have had in another court of the same State.

Id. at 88 L. Ed. 2d 884.

Here, the state court determined that the Plan was res judicata as to Movants' claims. This determination was

clearly erroneous, predicated as it was upon the belief that the Plan had finally determined claims because Movants' had not pursued the claims process. *See also Marrese v. American Academy of Orthopedic Surgeons*, 470 U.S., 84 L.Ed. 2d 274 (1985).

The state court, however, as I have shown, did not have jurisdiction. The stay was in effect: (1) the Plan itself expressly reserved litigation of this claim in this court; (2) the claim was and is still pending, either by virtue of the proof of claim or by the existence of the adversary proceeding.

Moreover, this is a federal statutory claim under §502(g) (rejection of an executory contract results in treatment "as if the claim had arisen before the date of the filing of the petition").

Eichman v. Fotomat, 759 F.2d 1434 (9th Cir. 1985), interpreting *Marrese*, is instructive. It held that preclusion did not apply where the state court had no jurisdiction. *Id.* at 1437, citing *Marrese*, 470 U.S., 84 L.Ed. 283 n.3: "We do not believe that federal courts should fashion a federal rule to preclude a claim that could not have been raised in the state proceeding."

Even if review of the state preclusion law is required, the state court's lack of jurisdiction would mean that the state court opinion is not *res judicata*. *See, e.g., Kohls v. Kohls*, 461 S.W. 2d 455, 461 (Tex.Civ.App. - Corpus Christi 1970, writ ref'd. n.r.e.).

Last, but not least, it is difficult to conceive of a preclusion rule that would prevent consideration by this Court. The state courts both presumed that this Court had issued a ruling in the claim. That had never occurred. While

a state court judgment *misinterpreting* an order of a federal court might not be subject to reconsideration under the doctrine of preclusion, how can a state court order on a ruling concerning a *non-existent* ruling or order of this Court be said to be preclusive?

CONCLUSION

Much has been said by the City of Brady concerning the conduct of Movants. After all, they urge, Movants created this mess by going to state court and not staying in this Court. If movants are to be "estopped," equity demands a look at the conduct of the City. In its brief on appeal, Brady argued: "They [movants] had a new cause of action ... which [movants] abandoned." As a matter of law, this statement is incorrect. Other misstatements or omissions are clear. Also, the City of Brady could always have asserted the stay.

Finally, it would be inequitable to let the city propose a plan treating this claim, reserve treatment of the claim to this Court, and then argue that the claim has been finally determined as disallowed — *when it had not been treated at all* — in order to persuade a state court that a final determination had been made and was *res judicata*.

For the reasons stated above, the Response of the City of Brady is overruled and a hearing will be set on the motion of the Movants concerning allowance of the claims and for distribution of those claims.

An order has been entered consistent with this opinion on this date.

Signed this 5 day of August, 1986.

/s/ R. Glen Ayers

R. GLEN AYERS
Bankruptcy Judge

APPENDIX E

**UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

No. 90-8282

D.C. Docket No. A 89 CA 429

FILED
JUL 24 1991

IN THE MATTER OF:
BRADY, TEXAS, MUNICIPAL GAS CORPORATION
Debtor.

GEORGE O. SANDERS, ET AL.,
Appellants
Cross-Appellees,

versus

- CITY OF BRADY, Successor-in-Interest,
Appellee
Cross-Appellant.

FILED
Aug 19 1991

* * * * *

A true copy
Test
Clerk, U.S. Court of Appeals,
Fifth Circuit
By: /s/ illegible
Deputy
New Orleans, Louisiana

AUG 15 1981

IN THE MATTER OF:
BRADY, TEXAS, MUNICIPAL GAS CORPORATION,
Debtor.

THE CITY OF BRADY, TEXAS,
Appellee
Cross-Appellant,

versus

GEORGE O. SANDERS, ET AL.,
Appellant
Cross-Appellee.

Appeals from the United States District Court for the
Western District of Texas

Before THORNBERRY, JOLLY and SMITH, Circuit
Judges.

J U D G M E N T

This cause came on to be heard on the record on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the bankruptcy court's order dismissing the appellants' claim against Brady Gas and its successor in interest, the City of Brady, is affirmed. Our ruling renders the City's cross appeal against the appellants moot; consequently, its cross-claim is dismissed.

IT IS FURTHER ORDERED that the cost on appeal be taxed against appellants, George O. Sanders, George H. O'Brien and Tanbark Oil Company 1978-1, Ltd.

July 24, 1991

ISSUED AS MANDATE: Aug 15 1991

APPENDIX F

11th Court of Appeals

Eastland, Texas

Opinion

**Tnabark Oil Company 1978-1, Ltd.,
George H. O'Brien and George O. Sanders**

Appellants

Vs. **No. 11-85-080-CV —
Appeal from Brown County**
City of Brady, Texas

Appellee

This is a summary judgment case. Tanbark Oil Company 1978, Ltd., George H. O'Brien and George O. Sanders sued Brady, Texas, Municipal Gas Corporation, predecessor in interest to the City of Brady, Texas, for removal of a cloud on title and for breach of contract. After Brady Gas' bankruptcy proceedings were completed, the trial court granted the City's motion for summary judgment. Tanbark, O'Brien and Sanders appeal. We affirm.

Appellant, O'Brien, entered into a farmout agreement with Brady Gas, the operator of a gas storage reservoir in the Janellen Field area. Under the terms of this agreement, Brady Gas was to assign to O'Brien, or his assignees, acreage within the leasees held by Brady Gas in the storage reservoir area upon the drilling and completion of wells to a depth either above or below the area designated as the gas storage reservoir. Through subsequent partial assignments, appellants Sanders and

Tanbark acquired interests in the farmout agreement. Appellants drilled three wells under the terms of the farmout agreement. Brady Gas refused to deliver assignments of the acreage allegedly earned by such wells contending that appellants had improperly drilled into the storage reservoir.

Appellants thereafter filed suit against Brady Gas in state district court on September 14, 1979, seeking judgment to quiet title through the assignment of legal title as required by the farmout agreement or in the alternative for damages incurred because of the failure to assign. On June 20, 1980, prior to trial, defendant Brady Gas filed a petition in bankruptcy under Chapter 11 of the Bankruptcy Code and the state court action was thereby stayed.

Appellants asserted and filed a proof of claim against the debtor's estate. Upon confirmation of the First Alternate Plan of Reorganization, appellants filed an appeal which was subsequently dismissed for want of prosecution. Also, during the pendency of the bankruptcy proceeding, appellant initiated an adversary action against the debtor for specific performance of the farmout agreement. This action was not pursued, and no judgment on the merits was ever entered.

On February 4, 1981, the United States Bankruptcy Court of the Western District of Texas, Austin Division, entered its Order Confirming Plan (of reorganization) in Case No. 1-80-00219-T, Brady, Texas, Municipal Gas Corporation, Debtor. Such plan called for assumption of all executory contracts other than the farmout agreement with O'Brien which had been rejected by Brady Gas. The plan further provided the following:

At the time Brady Gas was created in 1966, two

master documents were executed which control much of the existence of Brady Gas. One was an ordinance of the City of Brady passed on March 30, 1966, franchising Brady Gas as a natural gas utility. The second was an Indenture of Mortgage and Deed of Trust securing the issue of bonds by which Brady Gas was capitalized.

Under both of these instruments, the City of Brady has the right to pay off all of Brady Gas' bond debt and current liabilities. Upon making such payment, all assets of Brady Gas would transfer to the City and all contracts and obligations of Brady Gas would be assumed by the City.

The City of Brady has proposed to implement the provisions of the instruments named above so as to acquire the assets of and assume the contracts and obligations of Brady Gas. The closing for said transaction is proposed for February 5, 1981.

On February 5, 1981, appellee, pursuant to the plan, exercised provisions in a franchising ordinance and an Indenture of Mortgage and Deed of Trust, thereby assuming all assets, contracts, and obligations of Brady Gas. Appellee's motion for summary judgment urged that the bankruptcy proceeding operated as res judicata of all appellants' claims.

In a single point of error, appellants urge that the trial court erred in granting the summary judgment because at least one genuine issue of material fact still exists. Appellants concede that the trial court was correct in granting the motion with respect to the claim alleging equitable title. They argue, however, that the bankruptcy proceeding left intact their claim for damages resulting

from the alleged breach of contract by Brady Gas. Under the Bankruptcy Code, a rejection gives rise to a legal fiction that a breach of the contract occurred immediately prior to the filing of the petition. 11 U.S.C.A sec. 365 (g)(1) (1979). Thus, a claim is allowable for damages resulting from the breach. However, the claim for damages is to be presented to and determined by the bankruptcy court. *In re Davies*, 27 B.R. 898 (Bankr. E.D. N.Y. 1983). Appellants pursued no such claim in the bankruptcy court.

The plan in the instant case was confirmed by the bankruptcy court. An arrangement confirmed by a bankruptcy court has the effect of a judgment rendered by a district court. Any attempt by the parties to relitigate any of the matters that were raised or could have been raised therein is barred under the doctrine of res judicata. *Miller v. Meinhart-Commercial Corporation*, 462 F.2d 358 (5th Cir. 1972), *In re Union League Club of Chicago*, 203 F.2d 381 (7th Cir. 1953). Because appellants could have pursued the damage claim in the bankruptcy court but failed to do so, the claim is now barred by res judicata. The point of error is overruled.

The judgment of the trial court is affirmed.

/s/ Raleigh Brown
RALEIGH BROWN

ASSOCIATE JUSTICE

August 22, 1985

Not published. See Tex.R.CIV.P. 452.

APPENDIX G

NO. 21,138

VISTA RESOURCES, INC.,	X	IN DISTRICT
ET AL	X	COURT OF
	X	
V.	X	BROWN COUN-
	X	TY, TEXAS
	X	
BRADY, TEXAS, MUNICIPAL	X	
GAS CORPORATION, ET AL	X	35th JUDICIAL
	X	DISTRICT

*SUMMARY JUDGMENT IN FAVOR OF DEFENDANT
CITY OF BRADY, TEXAS AND
ORDER OF SEVERANCE*

BE IT REMEMBERED that on the 5th day of December, 1984, at the Brown County Courthouse in Brownwood, Texas, came on to be heard Defendant City of Brady's Motion for Summary Judgment in the above entitled and numbered cause wherein Vista Resources, Inc., Tanbark Oil Company, and George O'Brien, are Plaintiffs, and Brady, Texas, Municipal Gas Corporation, and The City of Brady, Texas, are Defendants, and it appearing to the Court that the Motion for Summary Judgment made by the City of Brady is in proper form and timely and that proper service thereof has been made and that the parties are properly before the Court for a hearing thereon; and it further appearing that the motion is accompanied by proper summary judgment proof in the form of affidavits and certified copies and that opposing affidavits have been served and are before the Court; and the Court having considered the pleadings and the summary judgment proofs and the Court having found an absence of any genuine issue of material fact concerning the question of liability of

the City of Brady, Texas, and that summary judgment should be rendered for Defendant City of Brady, Texas, it is accordingly ORDERED, ADJUDGED AND DECREED that Plaintiffs Tanbark Oil Company and George O'Brien take nothing of Defendant City of Brady, Texas, and that said Defendant go hence with his cost without day.

It further being the view of the Court that the action against the City of Brady, Texas, is clearly severable, and that same should be severed in order that the summary judgment hereby entered may become a final and appealable judgment; Plaintiffs' action against the City of Brady, Texas is hereby severed into a separate proceeding, and the Clerk of this Court is hereby directed to set up a separate file for the severed action against the City of Brady, Texas, and to enter this order of summary judgment and severance in present Cause No. 21,138 and in such now file as the Clerk may establish for the severed action against the City of Brady, Texas.

The Court further finds pursuant to motions and arguments regarding the authority of Vista Resources, Inc. to prosecute this suit as a Plaintiff that the right to do business in the State of Texas of Plaintiff Vista Resources, Inc. has been forfeited and that the cause of action, if any, was assigned to Tanbark Oil Company prior to such forfeiture; therefore, Plaintiff Vista Resources, Inc. is dismissed as a party to this suit as to both the original

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Cause No. 21,138 and as to the new cause number to be created pursuant to this order.

SIGNED this 14th day of December, 1984.

/s/ R. T. Pfeuffer

Robert T. Pfeuffer
Visiting District Judge

STATE OF TEXAS
COUNTY OF BROWN
CERTIFIED TO BE A TRUE AND CORRECT COPY
Of The Original in My Custody Vol ____ Page ____
Given Under My Hand and Sec. of Office
Dated March 12 AD. 1986
JAN BROWN
District Clerk of Brown County, Texas

By Kay Hill, Deputy